

Malawi: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Malawi

In the context of the second review under the three-year arrangement under the Poverty Reduction and Growth Facility with Malawi and request for a waiver of performance criteria, the following documents have been released and are included in this package:

- the staff report for the Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on May 18, 2006, with the officials of Malawi on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 15, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Press Release summarizing the views of the Executive Board as expressed during its August 30, 2006 discussion of the staff report that completed the review
- a statement by the Executive Director for Malawi.

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

HIPC Document

Letter of Intent sent to the IMF by the authorities of Malawi*

Memorandum of Economic and Financial Policies by the authorities of Malawi*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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MALAWI

Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria

Prepared by the African Department
(In consultation with other departments)

Approved by Robert Corker and Matthew Fisher

August 15, 2006

Discussions: Discussions for the second review of the three-year Poverty Reduction and Growth Facility (PRGF) arrangement were held in Lilongwe March 7–14 and May 11–18, 2006. The staff met with Minister of Finance Goodall Gondwe, Governor of the Reserve Bank of Malawi (RBM) Victor Mbewe, and other senior government officials. The staff also coordinated closely with donors and met with representatives of both the private sector and nongovernmental organizations. The staff team comprised Mr. McDonald (head), Mr. Staines, Mr. Steinberg (both AFR), Mr. Dalsgaard (FAD), Mr. Sterne (PDR), Ms. Koeda (FIN), Ms. Rendak (LEG), and Mr. Baunsgaard (Resident Representative). Mr. Choudhury (PDR) joined the mission in March to begin data-related work for a Debt Sustainability Analysis (DSA).

PRGF arrangement: A PRGF arrangement (SDR 38.2 million, 55 percent of quota) was approved on August 5, 2005 (Country Report 05/285), of which SDR 10.3 million has been disbursed. At end-May, Malawi had outstanding Fund purchases and loans totaled SDR 53.8 million (78 percent of quota). All quantitative end-December 2005 performance criteria were met. However, the structural performance criterion was only partially implemented and the structural performance criterion for end-March 2006 was also not fully met. The authorities, therefore, request waivers for nonobservance of these two performance criteria. Malawi is requesting the third disbursement under the current PRGF arrangement (SDR 4.9 million). Economic developments and policy implementation for the second half of 2005/06 (July-June) and the authorities program for 2006/07 are outlined in the attached Supplement to the Memorandum of Economic and Financial Policies (MEFP).

Key policy issues: Macroeconomic stability remains the main objective for 2006/07. Fiscal restraint is crucial to avoid adverse debt dynamics, and a flexible exchange rate policy should be maintained to protect international reserves.

Table of Contents

Executive Summary	4
I. Performance in 2005/06.....	6
A. Overview of Performance and Challenges.....	6
B. Ensuring Food Security.....	7
C. Addressing Foreign Exchange Imbalances	8
D. Meeting Monetary Policy Goals	10
E. Maintaining Fiscal Discipline.....	10
II. Policies for 2006/07	11
A. Reaching the HIPC Completion Point	12
B. Reducing Inflation and Restoring External Reserves	13
C. Consolidating Debt Reduction	13
D. Risks to Program Implementation.....	15
III. Structural Reforms	16
IV. Staff Appraisal	17

Tables

1a. Selected Economic Indicators, 2002-08	19
1b. Selected Economic Indicators on a Fiscal Year Basis, 2002/03-2008.....	20
2a. Central Government Operations, Quarterly	21
2b. Central Government Operations, 2002/03-2008/09 (In millions of Malawi kwacha)	22
2c. Central Government Operations, 2002/03-2008/09 (In percent of GDP).....	23
3a. Monetary Authorities' Balance Sheet, 2004-06.....	24
3b. Monetary Survey, 2004-06	25
4a. Balance of Payments, 2001-09	26
4b. Gross Financing Requirements and Sources of Financing, 2002-09	27
5a. Quantitative Targets, June 2005-March 2006.....	28
5b. Quantitative Targets, June 2005-December 2006.....	29
5c. Proposed Prior Actions, Structural Performance Criteria and Benchmarks, December 2005-December 2006	30
6a. Schedule of Disbursements Under the Three-Year PRGF Arrangement	31
6b. Indicators of Fund Credit, 2005-18.....	32

Appendices

I.	Letter of Intent	33
	Attachment I. Supplement to the Memorandum of Economic and Financial Policies of the Government of Malawi	35
	Table 1: Quantitative Targets, June 2005-March 2006, June 2005-December 2006	43
	Table 2. Proposed Prior Actions, Structural Performance Criteria and Benchmarks, December 2005-December 2006	45
	Attachment II: Technical Memorandum of Understanding.....	46
II.	Relations with the Fund	58
III.	IMF-World Bank Relations	61
IV.	Statistical Issues	67

Executive Summary

Despite a severe food crisis, real economic activity has unfolded largely as expected, with the key macroeconomic objectives for fiscal year 2005/06 likely met. Real GDP growth is expected to be 5.3 percent. Overall end-of period inflation exceeded expectations because of a slower-than-projected decline in food prices.

Macroeconomic performance in 2005/06 was broadly satisfactory. All quantitative performance criteria through December 2005 were met. However, management of the exchange system continued to be a concern with a backlog of unsatisfied import demand persisting. In addition, implementation of structural measures was uneven. The budget ceiling module (a structural performance criterion) was only partially implemented, as it was superseded by the introduction of a centralized payment system. The two fiscal structural benchmarks were met, but with a delay. The indicative target on government spending was missed due to higher than projected food security outlays.

Several developments complicated the program's implementation during the second half of 2005/06. Further scaling up of food security spending by the government was only partly offset by donor support. Payroll management also proved challenging, as the authorities sought to claw back initial overpayments. To help reduce arrears on import payments, the authorities implemented a more flexible exchange rate policy. Following the reduction in the liquidity reserve ratio, the RBM had to act to contain the growth in reserve money.

Despite notable difficulties, the authorities are expected to have met most quantitative targets for end-June 2006. The targets on domestic debt repayment and on discretionary government spending are likely to have been breached, largely because of higher food-security expenditures. The structural performance criterion related to the development and implementation of the government travel policy, scheduled for the end of March 2006, was only partially met. It will now be a structural benchmark for the third review.

The economic outlook for 2006/07 is favorable. According to the latest crop estimates, agricultural output should rebound significantly, pushing inflation to single digits. However, recent disruptions to the tobacco auction cloud external prospects.

Reducing the domestic debt burden will remain the cornerstone of the fiscal strategy. Tax cuts, in particular in the individual income tax, will reduce the tax/GDP ratio by about ½ percentage point, but this will be more than offset by expenditure restraint and the underlying fiscal balance will improve. Planned pension reforms will put the pension system on a sustainable track over the medium term.

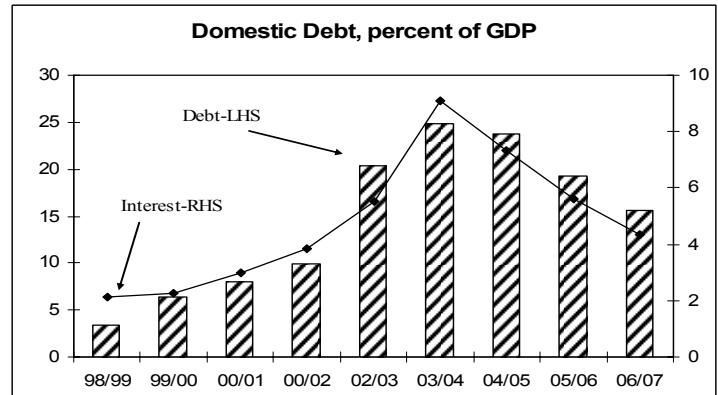
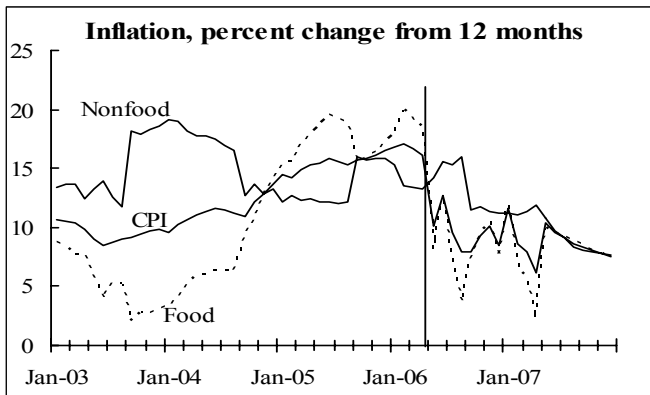
A flexible exchange rate policy will continue to be implemented, and the authorities will aim to protect their reserve cover. External reserves are projected to rise to almost two months of imports by the end of the fiscal year. Better management of the exchange system should prevent the recurrence of arrears on the payment for current international transactions.

Given the program's forward-looking policies and Malawi's steady track record, the Fund and Bank staffs recommend that Malawi reach the HIPC completion point on completion of the second review under the PRGF arrangement. Reaching the HIPC completion point would also qualify Malawi for debt relief under the Multilateral Debt Relief Initiative (MDRI).

I. PERFORMANCE IN 2005/06

A. Overview of Performance and Challenges

1. **Macroeconomic performance under the PRGF arrangement was broadly satisfactory.** Based on preliminary estimates, real GDP growth was 5.3 percent in 2005/06, domestic debt likely fell to 20 percent of GDP and, although overall inflation by end-June 2006 exceeded expectations, nonfood inflation was contained.



2. **Malawi comfortably met all end-December 2005 quantitative performance criteria.** The end-December 2005 indicative target on reserve money was met, but the indicative target on discretionary government spending was missed on account of additional spending related to the food crisis. An unexpected refund of debt service from the African Development Bank (AfDB) (for interim HIPC assistance due in 2004) and an unanticipated rise in project aid inflows contributed to Malawi's strong performance at end-December 2005. However, an inflexible exchange rate policy kept the backlog of unsatisfied import demand high.

3. **Implementation of structural measures has been uneven.** In November 2005, after only partial implementation, the budget ceiling module (a performance criterion) was superseded by a new centralized payment system.¹ Implementation of the new travel policy (a performance criterion for end-March 2006) has been delayed. While a policy was developed by a consultant, it has not been implemented because the authorities do not consider it to have met their objectives. The government will use its own resources to build on this work to complete and implement a new travel policy. This is now expected to be met by end-September, 2006 (a

¹ The new Integrated Financial Management Information System (IFMIS) and the centralized payment system makes the budget ceiling module less relevant because most payments no longer pass through the accounts system monitored by the budget ceiling module.

structural benchmark). The two structural benchmarks related to publishing reports on the budget and on expenditure arrears were met, but with a delay.

4. **Several developments during the second half of 2005/06** required the authorities to strengthen financial management controls and to make other policy adjustments.

- **The food security crisis was deeper than anticipated.** The resulting higher-than-programmed spending on food security, especially fertilizer, raised domestic borrowing levels and lowered external reserves.
- **Foreign exchange shortages and persisting arrears on import payments made Malawi's inflexible exchange rate policy difficult to sustain.**
- **External prospects became clouded by disruptions to the country's tobacco auctions.** Price disputes between buyers and growers shut tobacco auctions down for about two weeks in May 2006. This followed a presidential announcement in March to fix minimum prices for different tobacco grades that was not enforced.
- **Overcompensation and excess funding of the payroll led to a higher-than-programmed wage bill in third-quarter 2005/06.**
- **To keep inflation within program range, the RBM had to withdraw excess liquidity from the banking system,** following its reduction of the liquidity reserve ratio (LRR) in February 2006.

5. **The authorities' adjustments to their policy stance in response to these developments have been broadly appropriate.** As a result, at the end of June 2006, all quantitative targets are likely to have been met, except the performance criterion on domestic borrowing and the indicative target on discretionary government spending.

B. Ensuring Food Security

6. **While the economic impact of the food crisis was broadly as envisaged under the program,** the crisis had a larger-than-expected humanitarian toll, with about half the population becoming vulnerable to food shortages. The government's hunger relief efforts, with the support of donors, successfully averted a humanitarian crisis.

Malawi: Food Security Transactions in FY2005/06
(Net budget costs, billions of kwacha)

	Country Report	Country Report	Current			
	05/285	06/94	Total	Grants	Sales	Purchases
Fertilizer	-4.7	-5.4	-6.9	0.0	3.0	-9.9
Seeds	-0.1	0.8	0.3	0.6	0.3	-0.6
Pulses/Oils	0.0	0.0	0.0	1.3	0.0	-1.3
Maize	1.1	1.0	2.1	10.8	1.6	-10.3
Commercial	0.4	-0.5	-1.2	0.0	1.6	-2.8
Humanitarian	1.5	2.2	3.4	8.3	...	-4.9
Logistics	-0.8	-0.8	-0.1	1.4	...	-1.5
Replenishment for FY06/07	0.0	0.0	0.0	1.2	...	-1.2
Total	-3.7	-3.6	-4.5	12.6	4.9	-22.0

Source: Malawian authorities, donors and IMF staff estimates and projections

- **After the first review mission in late 2005, estimates of humanitarian needs increased,** largely because of an unanticipated trebling of maize prices.
- **To meet additional humanitarian needs, the government expanded its food security operations** (MEFP Box 1). Logistical difficulties in carrying out those operations led to higher-than-anticipated costs (particularly for transportation). As a result, budgetary expenditures on food and fertilizer subsidies were MK4.5 billion (1.7 percent of GDP) above levels envisaged at the first review. Donor funds and higher maize sales supported about three-quarters of this additional spending, resulting in a net budget cost of about MK0.9 billion.
- **The 2006 bumper maize crop brought the food crisis to an end.** Maize prices have begun to fall back to their seasonal norms.

C. Addressing Foreign Exchange Imbalances

7. **As reported in the first PRGF review, the authorities used informal administrative procedures to fix the exchange rate during first-half 2005/06.** These restrictions exerted downward pressure on external reserves and resulted in a backlog of unpaid import invoices. The need for food security operations and oil imports that were higher than envisaged, lower tobacco export prices, and exporters' reluctance to repatriate earnings contributed to the continued build-up in the backlog. In addition, access to foreign exchange was rationed selectively under the RBM's Guidelines for Foreign Exchange Trading Activities issued in April 2005 allowing it to direct commercial banks to give preference to invoices for fuel, maize, fertilizer, and other imports deemed essential.

8. **Staff continues to assess these restrictions.** Staff follow-up has confirmed that the authorities maintained an exchange restriction (as evidenced by the private external payment arrears) and a multiple currency practice under Article VIII (arising from the significant spread between the commercial bank exchange rate and the rates at foreign exchange bureaus). However, there is no evidence that the existing restriction was intensified, or that the multiple currency practice has been modified since the PRGF arrangement's approval.

9. **Since mid-January 2006, the authorities have taken clear steps to better manage the exchange rate system.** A more flexible exchange rate policy implemented in mid-January 2006 has lowered the exchange rate and helped protect international reserves. By end-June 2006, the exchange rate had depreciated by about 12 percent. The authorities have also been systematically measuring and monitoring the banking system's backlog of unpaid import invoices. Refinements in measuring the invoice backlog and conducting audits of foreign exchange demand have led the authorities to significantly lower backlog estimates. The more flexible exchange rate policy and increased RBM foreign exchange sales to the market have also helped reduce arrears on import payments.² In addition, the data available points to a reduction in the spread between the exchange rates offered by commercial banks and foreign exchange bureaus.³ This suggests that the backlog has not been reduced through an increase in parallel market activity.

10. **The program objective for net foreign assets will likely be met for end-June 2006.** This program achievement is notable, given the increase in foreign exchange sales to lessen the backlog of unpaid import invoices and weaker tobacco inflows owing to disrupted auctions.⁴ The authorities' policy decision to let the exchange rate depreciate, combined with stronger export receipts from tea, helped protect international reserves.

² In January 2006, the backlog of unpaid import invoices was an estimated US\$67 million. However, this estimate included some double counting of foreign exchange applications by the same importer at different banks. The RBM took steps to improve the estimates, including requiring banks to submit the unique exchange control numbers accompanying each application for foreign exchange. The RBM also began auditing the applications. By end-June 2006, the backlog was an estimated US\$12.7 million, and by late July it was eliminated.

³ The RBM collects information on the range of rates offered by the foreign exchange bureaus, but not on the transactions completed at each rate, making it difficult to measure the parallel market premium accurately. Nevertheless, the difference in the mid-point of the buy and sell rates offered by the RBM and by the foreign exchange bureaus fell from about 7 percent in early January 2006 to about 4 percent in early July 2006. Similarly, the premium on the mid-point selling rate as well as on the mid-point buying rate both fell by 2 percentage points over the same period.

⁴ Despite the resumption of tobacco auctions, both volumes and prices are down compared with the 2005 auction season. The decline in exports of processed tobacco is, however, less dramatic, as many such exports thus far in 2006 were bought at auctions held in late 2005.

D. Meeting Monetary Policy Goals

11. **The program's main monetary policy goal is price stability.** Overall 12-month inflation fell from a peak of 17 percent in February 2006 to 15.3 percent at end-June 2006. This was higher than anticipated because of a delayed response in food inflation to the bumper crop. On the other hand, performance on non-food inflation exceeded expectations as the pass-through of late-2005/early 2006 oil price increases and the effect of the recent exchange rate depreciation were weaker than anticipated.⁵ The monetary policy framework continues to rely on reserve money as a nominal anchor.

12. **Following the reduction in the LRR, the authorities agreed on the need to tighten the reserve money target to reduce excess liquidity and contain inflationary risks.** Given the lack of creditworthy projects, yields on treasury bills quickly fell following the announcement of the lower LRR. Nonetheless, the authorities acknowledged the monetary program risks and tightened the reserve money target. While not all the excess liquidity was eliminated, repurchase agreements using RBM bills and external reserve sales contained reserve money growth during the fourth quarter of 2005/06, and broad money growth remained largely in line with targets.

13. **Reducing the LRR supports the government's medium-term objectives of improving monetary policy implementation and deepening the financial system.** A lower LRR helped shift monetary policy away from reliance on direct instruments. The subsequent reduction in commercial bank intermediation costs has already yielded higher deposit rates and lower interest rate spreads.

E. Maintaining Fiscal Discipline

14. **After a stronger-than-programmed second quarter, fiscal performance weakened in the second half of 2005/06.** Malawi's relatively strong performance through December 2005 mostly reflected the AfDB's refund of debt service, delays in food security outlays and the postponement of the planned salary increase for the civil service. Scaled-up food security operations and some expenditure slippages hurt second half performance.

15. **The key fiscal challenge during second-half 2005/06 was to keep the annual wage bill on target (a performance criterion).** The government implemented the 2005/06 wage increase in February 2006 following careful preparations—including completing a database of all government employees (a performance criterion) and formulating a wage schedule (structural benchmark). Still, some employees were mistakenly overcompensated, resulting in a third-quarter overrun. Subsequent claw backs, and additional savings found by discontinuing excess

⁵ Staff estimate that over 2003-05, the pass through of increases in international oil prices to domestic retail prices in Malawi had been high.

funding uncovered on further scrutiny of the payroll, helped correct the overrun. The estimated annual wage bill is hence within program limits. However, spending on other goods and services and subventions exceeded program projections and added to expenditure pressures.

16. **Tax revenues outpaced expectations in particular during the fourth-quarter of 2005/06**, supported by the economic recovery and a tax enforcement campaign conducted by the revenue authority. Preliminary data indicates a revenue performance for the fiscal year that is about ½ percent of GDP better than programmed.

17. **Overall fiscal performance in 2005/06 has been satisfactory, especially given the challenges of food security operations.** The overall fiscal deficit (including grants) is unchanged from the program, i.e. 2 percent of GDP. However, a large statistical discrepancy—about 1 ¼ percent of GDP—blurs the comparison as this could reflect unrecorded spending or that non-tax revenues or privatization receipts are below expectations. Data has not yet been released to shed light on this discrepancy. Domestic borrowing, the government's key fiscal target, was 0.4 percent of GDP for the fiscal year, about 1 percent of GDP more than programmed. Scaled-up food security operations, noted above, and a shortfall in program support during the fourth quarter account for most of the overrun. The underlying balance is currently projected at -0.2 percent of GDP, but is likely to be revised upwards once the statistical discrepancy is clarified. In any event, the underlying balance for 2005/06 will be substantially lower than programmed, the single largest contributor to the shortfall being the additional spending on the fertilizer subsidy.

II. POLICIES FOR 2006/07

18. **The key macroeconomic objectives for 2006/07 remain largely consistent with the approved PRGF arrangement.** According to preliminary crop estimates, agricultural output should support a rebound in real GDP growth of about 7 percent and further dampen inflation (see Figure 1). Further reducing domestic debt and restoring external reserves will be key program objectives.

19. **The government is committed to program implementation; however, it holds a minority position in parliament and faces intense political pressure.** Getting parliament to approve a sound budget (a prior action for completing the second review) was an important test of the government's ability to sustain appropriate policies.

A. Reaching the HIPC Completion Point

20. **In reaching the HIPC completion point, Malawi will become eligible for relief under the MDRI.** The Fund and Bank staffs recommend that Malawi reach the completion point for the following reasons:⁶

- Completion of the second review establishes the minimum six months of satisfactory performance under the PRGF arrangement required to reach the HIPC completion point.
- The government circulated the third Annual Progress Report (APR) of its poverty reduction strategy for mid-2004 to end-2005 to both the Fund and Bank Boards, and the APR is available on the Fund's website. The Bank and Fund staffs have prepared a Joint Staff Advisory Note on the APR.⁷
- The government submitted a completed draft of its second poverty reduction strategy paper, the Malawi Growth and Development Strategy (MGDS), to the Malawian Cabinet in May 2006. The Cabinet commissioned a needs assessment of the strategy, with the goal of strengthening the implementation chapter, particularly the human and capital resource requirements. The government expects to resubmit the MGDS in coming months, and, on Cabinet approval, to submit it to the Bank and Fund staffs.
- The government has implemented all but two HIPC completion-point triggers: it intends to request waivers for the triggers relating to student enrollment in teacher training institutions and the percentage of recurrent expenditures on health.⁸

21. **The fiscal program for 2006/07 incorporates a flow of MDRI-related debt relief from the Fund, IDA, and AfDB of about US\$50 million.**⁹ Fund debt relief will be transferred from the RBM to the budget on a flow basis.¹⁰ Savings on debt service due to MDRI-related debt relief from IDA and AfDB should be largely offset by reduced program commitments. If

⁶ Malawi—Enhanced Initiative for Heavily Indebted Poor Countries—Completion Point Document; August 2006, Country Report 06/420.

⁷ Malawi—Joint Staff Advisory Note on the Annual Progress Report; Country Report 06/339.

⁸ The share of recurrent spending on health averaged 12 percent over 2001/05, falling short of the 13 percent target specified in the HIPC trigger. However, according to the budget allocation for 2005/06, the implementation of the health Sector-Wide Approach Program (SWAp) is expected to raise the share to 18 percent.

⁹ This amount includes about US\$10 million in HIPC assistance due in 2006/07. HIPC assistance from the IMF was previously retained by the RBM, but will henceforth be passed to the budget as the debt service falls due.

¹⁰ Debt relief will become effective as follows: from the Fund (under the MDRI), immediately at the HIPC completion point; from IDA, at the start of the next quarter after having reached the completion point; and from the AfDB, in January 2007, retroactive to November 2006.

necessary, a supplementary budget will allocate any remaining surplus MDRI funds to pro-poor spending activities.

22. **For monitoring purposes, the authorities are working with Fund staff and other stakeholders to redefine pro-poor spending for 2006/07.** Frequent revisions to pro-poor spending definitions in the past often introduced questionable components, making it difficult to track the extent to which the overall budget supports pro-poor spending.

B. Reducing Inflation and Restoring External Reserves

23. **The government is committed to a monetary policy anchored by a reserve money target to achieve price stability.** Over the next fiscal year, a projected deceleration in reserve money growth to 17 percent and a strong agricultural crop are expected to push inflation below 10 percent. A more modest rise in world oil prices—which should reduce the degree to which changes in the cost of domestic petroleum products boost prices—is also expected to help lower inflation.

24. **Restoring external reserves is a key program priority.** Gross reserves should be about 1.7 months of imports at end-June 2007, up from 1.3 months at end-June 2006. Net foreign assets will also rise steeply, as Fund debt relief under the MDRI will reduce debt owed to the Fund. Malawi's external position is unlikely to benefit from additional MDRI-related debt relief from the IDA and AfDB, as reductions in program support would offset reduced liabilities.

25. **The government has affirmed its commitment to a flexible exchange rate regime, as required by the monetary framework and Malawi's limited external reserves.** A higher level of external reserves in turn will enable the RBM to smooth seasonal fluctuations in the exchange rate. Consistent with the monetary framework, the government also recognizes that only policies that contain inflation and reduce domestic debt will bring about sustainably lower interest rates.

C. Consolidating Debt Reduction

26. **Reducing the domestic debt burden will remain the cornerstone of the fiscal strategy.** This will be attained by expenditure restraint (wages, goods and services, pensions) which in combination with lower interest payments and food security outlays more than offsets the effects of tax cuts in the personal income tax, and lower program grants. The program targets nominal debt repayments of 0.4 percent of GDP and aims to reduce domestic debt to about 16½ percent of GDP by the end of 2006/07. A shrinking debt stock, along with declining inflation, will allow interest rates to drop somewhat. The government will also strive to strengthen its cash management, so that some government deposits will be available to offset ways-and-means advances at the RBM. Savings on domestic interest costs will support priority expenditures.

27. **The program incorporates a strong fiscal effort.** The overall deficit (including grants) is projected to decline to about 1¼ percent of GDP, and the underlying balance to improve substantially from 2005/06, to a surplus of about 1 percent of GDP.

- **Spending on food security, while much lower than in 2005/06, will remain an integral part of the government's budget.** The government will take advantage of the bumper maize crop to replenish the Strategic Grain Reserve and sell maize through the agricultural development marketing company (ADMARC) at full cost recovery. The government will again import fertilizer for resale, but with a slightly lower subsidy (2.4 percent of GDP, compared with 2.6 percent of GDP in 2005/06).¹¹
- **There will be no formal across-the-board wage adjustments.** Following the significant wage increases of recent years, only a few categories of workers who did not receive 2005/06 wage adjustments, such as the judiciary, will receive 2006/07 increases. Estimates of the 2006/07 wage bill, excluding the Health SWAp, will stay below 7.5 percent of GDP (in line with the 2005/06 wage bill).
- **The government has taken further steps to ensure the viability of the pension system.** Under the current formula, 2006/07 pension costs would increase significantly, as the 2004 wage reforms changed the base against which pension benefits are assessed. Following FAD guidance, the authorities have agreed to substantially reduce the pension system's replacement rate. In particular, they plan to lower the pension accrual rate and introduce a discount factor to the pension share paid out as a lump-sum gratuity. To protect pensioners' real income, the authorities plan to index pension benefits to inflation. The 2006/07 pension bill is expected to be about MK4.8 billion, or 1.5 percent of GDP (versus an estimated 1.2 percent of GDP in 2005/06). Over the medium term, pension costs should stay below 2 percent of GDP, a fiscally sustainable level. Reforming the pension system is a prior action for completing the program's second review.
- **Other measures will contain recurrent spending.** Spending on other goods and services should increase at the nonfood inflation rate rather than the nominal GDP growth rate. To contain such spending, the government has implemented improved civil service housing policies and restrictions on the use of government vehicles. Administrative measures as well as the planned full implementation of the IFMIS should also help prevent new utility arrears.

¹¹ A recent Poverty and Social Impact Analysis by FAD concluded that the current voucher-based fertilizer subsidy scheme is not very successful in targeting the benefit to the intended recipients. The study recommends an increased focus on smallholder productivity (promoting more advanced farming techniques along with the subsidy), better targeting of the subsidy (by offering fertilizer, rather than cash, for smallholders participating in public works projects), and more involvement of private sector fertilizer providers.

- **The new policy to clear the large stock of domestic arrears has had a successful start.** To accelerate the clearance of such arrears, beyond the MK 2 billion allocated to arrears clearance in 2006/07, the government is considering offering securitization of part of the arrears (the program includes an adjuster for such an initiative)..
- **The initial costs of a new parliament building will be contained to MK0.7 billion in 2006/2007.** Total costs are projected to reach MK 6 billion over several years, for which one donor has so far indicated a readiness to provide support.
- **The budget incorporates a substantial increase in development spending – almost 3 percent of GDP - that is mostly foreign-financed.** While this is laudable, it is questionable whether the absorptive capacity exists to implement all the planned spending.

D. Risks to Program Implementation

28. **Malawi's economy remains especially vulnerable to the effects of crop shortfalls and higher world oil prices.** Crop shortfalls could disrupt tobacco export earnings, lead to food shortages and require costly food security operations, and threaten Malawi's already low external reserves position. Malawi suffered a terms-of-trade decline of almost 18 percent in 2005 and is vulnerable to continued declines in 2006/07 if the international price of oil continues to rise or if the export price of tobacco experiences a dramatic decline.

29. **In addition to general macroeconomic risks, budget implementation faces several uncertainties that will need to be monitored closely and may need offsetting measures.** The government will need to guard against a recurrence of overruns in the wage bill. There is also some risk that pension projections, which make demographic assumptions about new retirees and mortality rates using questionable historical data, could prove too optimistic. This may require the authorities to recalibrate their projections and the pension formula. Construction of the parliament building, although budgeted for in 2006/07, could create future cost overruns. Weak accounting systems may not capture the accumulation of new expenditure arrears. The government will need to pay attention to constraints on absorption capacity that may threaten the quality of the large increase in development expenditures.

30. **The budget also faces potential contingent liabilities which, should they materialize, will need to be addressed by offsetting expenditure measures.** The Malawi Rural Development Fund's (MARDEF) operational costs are expected to be fully covered by its lending revenues, and the government is committed to a self-financing scheme. There is some risk, however, that the government may lose the funds it already transferred into the loan scheme (up to 1.5 percent of GDP), and may thus be pressured to make additional transfers. In addition to the recurrent risk of overruns in ADMARC's operational spending, there are potential contingent liabilities arising from allowing ADMARC to borrow commercially and pressures to sell maize below cost recovery. The restructuring of the Malawi Development Corporation,

following its failure to make payments on government-guaranteed debt, valued at about 0.5 percent of GDP, may also impose a cost on the budget.

III. STRUCTURAL REFORMS

31. **The authorities medium-term agenda for carrying out structural reforms is being developed in the context of the MGDS.** The PRGF-supported program, which focuses on the macro-relevant areas, emphasize reforms in public financial management (PFM) and the financial sector in 2006/07. A more comprehensive agenda of structural conditionality will be elaborated at the time of the third review once the MGDS is finalized.

32. **To ensure the effective use of public resources, Malawi will work to improve its PFM systems.** The 2004 Assessment and Action Plan, conducted jointly by the Bank and the Fund, highlighted several areas for improvement, including budget comprehensiveness, internal control and reconciliation in budget execution, and audited financial reports. Other diagnostic assessments have reached similar conclusions. The government, with the help of donors, is developing an action plan to address PFM weaknesses (a structural benchmark for end-October 2006). The phasing in of the new IFMIS and centralized payment system marks an important first step in these reforms. Fund staff will work with the authorities to implement the action plan. In this regard, capacity building will be critical and Malawi is expected to request technical assistance from the Fund and other donors.

33. **Medium-term challenges include successfully deepening financial intermediation and developing credit markets.** To strengthen banking supervision, the government recently completed an impact analysis of commercial bank balance sheets using asset classifications consistent with international best practices (a structural benchmark). In carrying out this analysis, the authorities relied on substantial technical advice from MFD. The government expects to receive a Financial Sector Assessment Program (FSAP) in early 2007. Fund staff will begin identifying key strategic areas to focus the assessment, both from the point of view of stability and development of the financial system.

34. **Strengthening the RBM's functioning would improve overall governance in the financial sector.** In late 2005, a follow-up safeguard assessment mission from the Fund identified several remaining weaknesses in the RBM's operations, particularly in the areas of transparency and accountability. A key issue was that the extended lack of a board of directors left the RBM vulnerable to mismanagement. In March 2006, the government reconstituted the board, which then reestablished the audit committee. The Southern African Development Community (SADC) will guide the government's efforts to strengthen the independence of the central bank. The government plans to adopt a version of a forthcoming SADC model law as soon as possible.

IV. STAFF APPRAISAL

35. **Malawi is expected to meet its growth target for 2005/06.** This performance is especially notable given the recent food crisis, which authorities describe as the most severe in 50 years. The increased spending on food security was appropriate, and the staff commends the government for its success in averting a humanitarian crisis.
36. **Macroeconomic performance through December 2005 was broadly satisfactory.** Malawi met all quantitative performance criteria under the PRGF-supported program. It also met the indicative target on reserve money, but missed the target on discretionary government spending. Weak exchange rate management, however, marred the country's program performance. Implementation of structural measures was also uneven. In addition to higher-than-anticipated spending on food security operations, the authorities contained a wage bill overrun and fought inflation in an environment of higher world oil prices.
37. **Staff support the authorities' request for waivers on the two structural performance criteria.** The budget ceiling module was not implemented as it was superseded by the implementation of the centralized payment system in November 2005. The authorities were not satisfied with the proposals for the new travel policy, which were too general to be operational, and now expect to develop and implement a new travel policy by end-September 2006 (a structural benchmark).
38. **The authorities have begun to improve their exchange rate management policies.** The implementation of a more flexible exchange rate policy since January 2006 is welcome, and the resulting depreciation of the kwacha, coupled with tighter domestic policies, has been appropriate. A more flexible exchange rate policy, better measurement of unsatisfied foreign exchange demand, and increased RBM foreign exchange sales to the market have eliminated the backlog of arrears on import payments within the banking system. To protect Malawi's relatively low reserve cover, the authorities need to continue to implement a flexible exchange rate policy.
39. **The authorities, on the whole, ably managed challenges to macroeconomic policy implementation in second-half of 2005/06.** Malawi is expected to meet all but two end-June quantitative targets. The discretionary government spending and borrowing targets will be missed primarily because of scaled-up spending on food security. Notably, the government's announcement that it would fix minimum prices on tobacco grades disrupted tobacco auctions and reduced foreign exchange inflows. While staff welcomes efforts to improve the auctions, it urges the authorities to avoid similar policy missteps in the future.
40. **Prospects for the coming fiscal year are positive.** A strong agricultural harvest should help GDP growth rebound, and inflation should continue to fall. However, to reduce poverty over the medium term, Malawi must realize even higher growth rates in 2007/08 and beyond. Despite some uncertainty related to tobacco markets, external prospects have improved. Program

objectives for 2006/07 are realistic, and staff welcomes the government's continued commitment to reducing the domestic debt burden. In addition to pursuing prudent monetary policy, the authorities should be prepared to reduce excess liquidity in the banking system to meet inflation objectives.

41. **The emphasis on structural reforms in public financial management and in the financial sector are appropriate.** Strengthened expenditure management will help ensure that resources freed up by debt relief are used effectively. Governance of the financial sector is also important and staff welcomes the steps being taken to address the recommendations of the Fund's safeguard assessment.

42. **The program, however, is not without risks.** Malawi's projected foreign exchange reserve cover is still relatively low, leaving the economy especially vulnerable to both domestic and external shocks. Strong policy implementation is critical to mitigate these risks. On the fiscal side, a history of poor payroll management could lead to wage overruns. Pension outlays, which rely on assumptions that use questionable demographic data, could also turn out to be higher than programmed. To reduce these risks, the authorities need to continue implementing payroll management reforms, continually update the civil service database, and improve retiree and worker mortality data. Potential contingent liabilities to the budget also need to be managed by ensuring proper governance in the administration of ADMARC and MARDEF.

43. **On the basis of performance through end-December 2005 and in the second half of the fiscal year, as well as the authorities' continued commitment to successful program implementation, staff recommend completion of the second review under the PRGF arrangement.** Given Malawi's track record under the PRGF, and its satisfactory implementation of the HIPC completion point triggers, the Fund and Bank staffs recommend that Malawi advance to the HIPC completion point, making it immediately eligible for additional debt relief under the MDRI.

Table 1a. Malawi: Selected Economic Indicators, 2002–08

	2002	2003	2004	2005		2006		2007	2008
	Act.	Act.	Act.	Prog.	Act.	Prog.	Proj.	Proj.	Proj.
National income and prices									
GDP at constant factor prices	2.1	3.9	5.1	2.1	2.1	8.3	8.4	5.6	6.0
Nominal GDP (billions of kwacha)	148.4	171.9	207.2	240.9	245.7	296.6	303.5	345.2	393.0
Nominal GDP per capita (U.S. dollars)	160.3	143.1	150.9	158.2	161.4	164.1	167.2	171.8	182.1
GDP deflator	16.6	9.2	12.5	16.2	15.4	10.9	13.9	7.7	7.4
Consumer prices (end of period)	11.5	9.8	13.7	16.9	16.5	4.9	7.9	8.0	7.4
Food	8.2	3.0	14.1	19.2	17.2	1.0	8.7	7.4	7.3
Nonfood	15.9	18.6	13.3	13.8	15.8	10.6	8.2	9.0	7.4
Consumer prices (annual average)	14.9	9.6	11.4	15.5	15.5	9.8	13.1	7.2	7.5
Investment and savings (percent of GDP)									
National savings	-0.8	3.3	5.1	10.4	8.6	11.1	7.9	16.7	17.6
<i>Of which</i> : domestic savings	-11.0	-11.7	-9.9	-8.1	-10.3	-6.4	-9.3	-3.5	-1.1
unrequited transfers	12.6	17.3	17.4	20.6	21.0	19.5	18.8	21.2	19.6
Gross investment	10.4	10.9	14.4	16.4	14.5	15.7	15.6	18.5	18.7
Foreign savings	-11.2	-7.6	-9.3	-6.0	-5.9	-4.6	-7.7	-1.8	-1.1
Central government (percent of GDP)									
Revenue (excluding grants)	17.7	22.0	23.2	24.8	25.5	23.8	24.4	23.9	23.9
Expenditure and net lending	35.1	39.3	43.9	48.3	46.5	41.7	43.1	41.3	39.5
Underlying balance ^{1/}	-2.8	-0.5	1.0	-1.5	-0.5	1.4	0.5	0.5	0.4
Overall balance (excluding grants)	-17.4	-17.3	-20.7	-23.8	-21.0	-17.9	-18.8	-17.4	-15.6
Overall balance	-11.6	-6.5	-6.5	-4.6	-4.5	-1.8	-3.4	0.1	-0.2
Money and credit (change in percent of beginning-of-year M2)									
Money and quasi money	25.2	29.3	29.8	16.1	14.3	19.1	22.1	13.7	14.5
Net foreign assets	-55.4	21.5	6.0	10.8	5.0	13.1	6.3	15.3	15.2
Net domestic assets	80.6	7.8	23.8	5.3	9.3	6.0	15.7	-1.5	-0.7
Credit to the government	45.1	11.3	10.3	17.4	2.2	0.2	25.0	-18.1	-14.6
Credit to the rest of the economy	4.1	8.1	11.3	4.9	5.6	2.1	-4.1	3.9	0.2
Velocity	5.4	4.9	4.5	4.5	4.7	4.8	4.8	4.8	4.7
External sector (millions of U.S. dollars)									
Exports, f.o.b.	421.1	440.6	470.0	536.4	524.2	557.6	572.0	592.9	611.4
Imports, c.i.f.	-726.8	-791.6	-893.9	-983.7	-997.6	-986.8	-1,069.8	-1,048.6	-1,049.2
Usable gross official reserves	103.4	115.6	119.3	142.2	131.2	183.2	113.9	206.5	299.3
(months of imports)	1.4	1.4	1.3	1.6	1.4	2.0	1.2	2.2	2.9
Current account (excluding grants)	-23.8	-24.9	-26.7	-26.5	-26.8	-24.1	-26.5	-23.0	-20.7
Nominal effective exchange rate	-28.6	-23.6	-4.3	...	-11.4	...	...	...	...
Real effective exchange rate	-24.8	-17.2	5.5	...	0.1	...	...	...	...
Terms of trade	-7.6	-4.8	-2.7	-7.5	-17.6	7.2	-1.2	-0.3	-0.6
Debt stock and service (percent of GDP)									
External debt (public sector)	143.3	158.9	148.1	143.7	136.8	135.3	47.8	31.9	31.8
NPV of debt (percent of avg. exports)	278.4	268.0	257.7	274.4	237.0	261.7	220.0	205.8	194.3
External debt service (percent of export)	18.3	21.8	22.9	18.9	21.5	23.3	16.2	6.4	6.0
Net domestic debt (central government)	17.4	22.3	22.6	22.0	21.9	17.9	19.7	14.7	10.6
Domestic interest payment	4.0	7.9	8.4	6.2	6.3	5.2	4.9	3.5	2.7
Treasury bill rate (period average)	41.7	39.3	28.6	...	24.4	...	...	...	...

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

^{1/} A measure of domestic adjustment effort (i.e., domestic primary balance excluding maize and the Health SWAp). Definition: Overall balance plus statistical discrepancy, excluding grants, revenue and expenditure from maize, interest, foreign-financed development expenditures, and the Health SWAp.

Table 1b. Malawi: Selected Economic Indicators on a Fiscal Year Basis, 2002/03–2008/9

	2002/03	2003/04	2004/05	2005/06		2006/07	2007/08	2008/09
	Act.	Act.	Act.	Prog.	Proj.	Proj.	Proj.	Proj.
National income and prices								
GDP at constant factor prices	3.0	4.5	3.5	5.1	5.3	7.0	5.8	6.0
Nominal GDP (billions of kwacha)	160.1	189.6	226.5	271.0	274.6	324.4	369.1	420.1
Nominal GDP per capita (U.S. dollars)	154.0	142.6	160.1	161.2	164.3	168.2	177.2	187.9
GDP deflator	15.6	11.0	14.1	12.9	14.6	10.6	7.5	7.4
Consumer prices (end of period)	8.5	11.6	15.9	10.3	15.3	5.7	7.4	7.4
Food	4.0	6.3	19.6	7.8	17.5	3.4	7.3	7.3
Nonfood	13.9	17.5	12.1	16.1	12.9	10.5	7.5	7.4
Consumer prices (annual average)	16.7	10.1	13.6	14.9	16.1	8.1	7.8	7.4
Investment and savings (percent of GDP)								
National savings	0.2	4.3	6.4	10.3	8.6	14.3	16.5	17.0
<i>Of which</i> : domestic savings	-12.6	-10.7	-10.8	-7.7	-9.1	-4.5	-3.0	-1.6
unrequited transfers	15.1	17.3	19.3	20.0	19.8	20.1	20.4	19.4
Gross investment	9.5	12.8	13.8	16.2	15.5	18.9	17.9	18.9
Foreign savings	-9.3	-8.5	-7.5	-6.0	-6.9	-4.5	-1.4	-1.9
Central government (percent of GDP)								
Revenue (excluding grants)	20.0	22.6	25.1	24.5	24.9	24.2	24.2	23.7
Expenditure and net lending	38.3	42.5	43.1	45.3	46.1	43.1	39.4	38.7
Underlying balance 1/	-1.7	-0.9	2.3	1.8	-0.2	1.0	0.6	0.4
Overall balance (excluding grants)	-18.3	-19.9	-18.0	-20.8	-21.2	-19.0	-15.2	-15.0
Overall balance	-11.6	-7.8	-5.6	-2.0	-2.0	-1.3	-0.4	0.0
Money and credit (change in percent of beginning-of-year M2)								
Money and quasi money	24.1	35.6	18.4	18.0	18.7	18.0	13.8	15.0
Net foreign assets	-5.3	8.6	5.8	8.2	4.6	11.8	12.7	12.0
Net domestic assets	29.4	27.0	12.7	9.8	14.0	6.2	1.1	3.1
Credit to the government	40.3	20.9	9.4	-9.0	-4.7	9.0	-13.7	-10.7
Credit to the rest of the economy	7.5	2.5	14.0	6.2	5.3	-6.7	2.7	-1.6
Velocity	5.3	4.6	4.7	4.8	4.8	4.8	4.8	4.7
External sector (millions of U.S. dollars)								
Exports, f.o.b.	422.2	447.6	501.9	525.3	536.8	578.4	600.2	620.4
Imports, c.i.f.	-850.6	-781.8	-928.6	-1,012.4	-1,036.9	-1,076.3	-1,035.0	-1,088.5
Usable gross official reserves	89.7	93.6	112.4	137.2	126.4	160.0	223.6	298.0
(months of imports)	1.1	1.0	1.2	1.5	1.3	1.7	2.2	2.7
Current account (excluding grants)	-24.4	-25.9	-26.8	-26.0	-26.6	-24.6	-21.8	-21.3
Nominal effective exchange rate 2/	-21.0	-21.6	-9.7	...	-3.0	...	...	...
Real effective exchange rate 2/	-17.3	-14.5	2.1	...	8.7	...	...	...
Domestic debt (percent of GDP)								
Net domestic debt (central government)	20.4	24.8	23.8	19.3	20.0	16.5	12.8	8.6
Domestic interest payment	5.5	9.1	7.4	5.5	5.4	4.3	3.1	2.2
Treasury bill rate (period average)	38.3	36.3	24.5	...	...	...	...	...

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

1/ A measure of domestic adjustment effort (i.e., domestic primary balance excluding maize and the Health SWAp).

Definition: Overall balance plus statistical discrepancy, excluding grants, revenue and expenditure from maize, interest, foreign-financed development expenditures, and the Health SWAp.

2/ Based on data through December 2005.

Table 2a. Malawi: Central Government Operations, Quarterly
(In millions of Malawi kwacha)

	2005/06 Program						2005/06 Current					
	Q1	Q2	Q3	Q4	Annual	Percent	Q1	Q2	Q3	Q4	Annual	Percent
	Prog.	Prog.	Prog.	Prog.	Prog.	of GDP	Proj.	Proj.	Proj.	Proj.	Proj.	of GDP
Total revenue and grants	28,135	32,348	24,686	32,225	117,394	43.3	28,137	34,000	27,169	31,836	121,143	44.1
Revenue	16,347	15,413	17,336	17,268	66,364	24.5	16,339	15,344	17,234	19,433	68,350	24.9
Tax revenue	13,892	13,363	14,911	15,850	58,016	21.4	13,892	13,634	15,189	17,212	59,927	21.8
Nontax revenue	2,455	2,050	2,425	1,418	8,348	3.1	2,447	1,710	2,045	2,222	8,423	3.1
Of which: sales receipts maize	375	391	391	0	1,157	0.4	300	504	778	0	1,582	0.6
Grants	11,788	16,935	7,350	14,957	51,030	18.8	11,798	18,656	9,936	12,403	52,793	19.2
Budget/ program support	4,407	6,519	397	3,835	15,159	5.6	4,407	6,519	392	3,009	14,327	5.2
Project	3,317	4,343	3,067	4,458	15,185	5.6	3,223	3,488	3,247	2,902	12,861	4.7
Dedicated grants	2,529	4,199	2,223	4,694	13,645	5.0	2,634	5,755	4,838	4,696	17,923	6.5
DFID/EU	684	3,330	0	1,171	5,185	1.9	681	3,288	2,570	1,201	7,741	2.8
National Aids Commission (NAC)	361	256	1,340	1,364	3,320	1.2	455	1,928	264	564	3,211	1.2
Health swap	1,485	612	883	2,159	5,139	1.9	1,497	539	2,004	2,699	6,740	2.5
HIPC debt relief	1,535	1,874	1,662	1,970	7,041	2.6	1,535	2,893	1,459	1,796	7,683	2.8
MDRI debt relief from IMF	0	0	0	0	0	0.0	0	0	0	0	0	0.0
Total expenditure and net lending	27,782	37,680	26,641	30,739	122,842	45.3	28,821	35,808	34,773	27,184	126,585	46.1
Current expenditure	19,077	28,850	19,100	21,024	88,051	32.5	20,674	25,979	26,828	20,295	93,776	34.1
Wages and salaries	4,806	4,901	5,207	5,535	20,448	7.5	4,802	4,790	5,764	5,092	20,448	7.4
Of which: Health Swap	138	0	184	408	730	0.3	138	199	159	234	730	0.3
Interest payments	4,428	4,777	4,758	4,405	18,368	6.8	4,393	4,778	4,964	3,977	18,112	6.6
Domestic	3,674	3,837	3,931	3,466	14,909	5.5	3,674	3,909	4,213	3,056	14,852	5.4
Foreign	754	940	827	938	3,459	1.3	719	869	751	921	3,259	1.2
Other current expenditure	9,844	19,172	9,135	11,085	49,235	18.2	11,478	16,412	16,100	11,227	55,217	20.1
Purchases of goods and services	6,471	10,162	5,659	7,632	29,923	11.0	5,824	7,489	12,573	7,543	33,430	12.2
Maize	1,003	5,967	347	1,180	8,497	3.1	835	2,626	4,977	685	9,122	3.3
Pulses and oils	0	0	0	0	0	0.0	0	0	1,260	0	1,260	0.5
Health SWAp	1,419	0	980	1,474	3,873	1.4	1,422	0	790	2,448	4,660	1.7
Elections	0	0	0	261	261	0.1	22	39	0	420	480	0.2
Other goods and services	4,049	4,195	4,332	4,716	17,292	6.4	3,547	4,825	5,546	3,990	17,908	6.5
Subsidies and transfers	2,769	8,510	2,976	3,057	17,312	6.4	5,017	8,024	3,094	3,652	19,786	7.2
Pension and gratuities	716	800	846	846	3,208	1.2	716	860	710	922	3,208	1.2
Fertilizer subsidy	0	5,635	0	0	5,635	2.1	2,200	4,974	0	0	7,174	2.6
Other subsidies and transfers	2,052	2,075	2,130	2,211	8,469	3.1	2,101	2,190	2,384	2,730	9,404	3.4
Arrears	604	500	500	396	2,000	0.7	637	899	433	31	2,000	0.7
Development expenditure	8,002	9,533	7,541	9,715	34,791	12.8	8,147	9,828	7,945	6,889	32,809	11.9
Part I (foreign financed)	7,169	8,597	6,586	8,619	30,972	11.4	7,314	8,783	6,734	5,985	28,817	10.5
Part II (domestically financed)	833	936	955	1,096	3,819	1.4	833	1,045	1,210	904	3,992	1.5
Net lending	703	-703	0	0	0	0.0	0	0	0	0	0	0.0
Overall balance (including grants)	353	-5,332	-1,955	1,486	-5,448	-2.0	-684	-1,807	-7,604	4,653	-5,442	-2.0
Spending directly related to privatization 1/	0	0	2,225	0	2,225	0.8	0	0	0	2,752	2,752	1.0
Augmented balance	353	-5,332	-4,180	1,486	-7,673	-2.8	-684	-1,807	-7,604	1,901	-8,194	-3.0
Total financing	-753	3,155	6,758	-1,486	7,673	2.8	-514	2,319	7,694	2,019	11,518	4.2
Foreign (net)	891	1,580	2,948	354	5,773	2.1	1,130	763	749	3,712	6,354	2.3
Borrowing	3,084	4,038	5,529	3,166	15,817	5.8	3,324	3,589	2,982	6,224	16,119	5.9
Program	0	0	3,351	0	3,351	1.2	0	0	0	3,373	3,373	1.2
Project	3,084	4,038	2,179	3,166	12,467	4.6	3,324	3,589	2,982	2,851	12,746	4.6
Amortization	-2,193	-2,457	-2,581	-2,812	-10,044	-3.7	-2,193	-2,826	-2,233	-2,512	-9,764	-3.6
Domestic (net)	-1,644	1,574	250	-1,840	-1,661	-0.6	-1,644	1,556	6,945	-5,776	1,081	0.4
Banking system	-8,994	2,271	2,094	95	-4,535	-1.7	-8,994	2,252	5,927	-1,567	-2,382	-0.9
Nonbanks	7,350	-697	-1,844	-1,935	2,874	1.1	7,350	-696	1,019	-4,209	3,464	1.3
Privatization proceeds	0	0	3,560	0	3,560	1.3	0	0	0	4,083	4,083	1.5
Discrepancy	400	2,177	-2,578	0	0	0.0	1,198	-512	-91	-3,920	-3,324	-1.2
Memorandum items:												
Nominal GDP	270,989	270,989	270,989	270,989	270,989	100.0	274,634	274,634	274,634	274,634	274,634	100.0
Net domestic debt	52,278	53,852	54,102	52,262	52,262	19.3	52,278	53,834	60,780	55,004	55,004	20.0

Sources: Malawian authorities; and IMF staff estimates.

1/ Includes 2005/06 transactions related to the sale of MTL: rentrenchment costs and the capital injection less debt repayment.

Table 2b. Malawi: Central Government Operations, 2002/03 – 2008/09
(In millions of Malawi kwacha)

	2002/03	2003/04	2004/05	2005/06		2006/07	2007/08	2008/09
	Act.	Act.	Est.	Prog.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	42,685	65,817	85,075	117,394	121,143	135,514	143,848	162,682
Revenue	32,009	42,754	56,809	66,364	68,350	78,355	89,336	99,504
Tax revenue	27,251	36,902	49,798	58,016	59,927	69,152	78,568	87,781
Nontax revenue	4,758	5,852	7,011	8,348	8,423	9,203	10,768	11,723
<i>Of which</i> : sales receipts maize	591	1,351	468	1,157	1,582	800	1,500	1,500
Grants	10,675	23,063	28,267	51,030	52,793	57,159	54,512	63,178
Budget/ Program support	1,220	6,576	5,085	15,159	14,327	9,652	12,602	14,990
Project	4,604	6,518	11,020	15,185	12,861	24,242	23,355	36,675
Dedicated grants	188	4,219	7,083	13,645	17,923	14,502	12,063	6,194
HIPC debt relief	3,588	5,261	5,078	7,041	7,683	5,078	4,515	4,123
MDRI debt relief from IMF	0	0	0	0	0	3,685	1,977	1,196
Total expenditure and net lending	61,322	80,536	97,670	122,842	126,585	139,887	145,504	162,531
Current expenditure	49,473	59,537	71,962	88,051	93,776	91,465	96,394	104,422
Wages and salaries	10,930	12,337	17,056	20,448	20,448	23,375	26,673	30,250
<i>Of which</i> : Health SWAp	0	0	94	730	730	1,019	1,232	1,297
Interest payments	10,985	20,024	19,612	18,368	18,112	15,645	12,674	10,718
Domestic	8,871	17,253	16,650	14,909	14,852	13,791	11,342	9,201
Foreign	2,114	2,771	2,962	3,459	3,259	1,854	1,332	1,517
Other current expenditure	27,559	27,176	35,294	49,235	55,217	52,444	57,047	63,454
Purchases of goods and services	20,127	18,416	20,227	29,923	33,430	29,479	30,350	35,596
Maize	6,078	0	2,447	8,497	9,122	2,080	1,500	1,500
Pulses and oils	0	0	0	0	1,260	0	0	0
Health SWAp	0	0	984	3,873	4,660	6,123	4,670	4,897
Elections	10	2,029	63	261	480	1,000	369	2,100
Other goods and services	14,039	16,388	16,733	17,292	17,908	20,276	23,812	27,099
Subsidies and other current transfers	7,431	7,410	13,600	17,312	19,786	20,965	23,697	24,858
Pension and gratuities	1,431	1,613	2,106	3,208	3,208	4,763	6,101	7,240
Fertilizer/Seeds subsidy	0	0	4,374	5,635	7,174	7,660	6,760	6,260
Other subsidies and transfers	6,000	5,797	7,121	8,469	9,404	8,542	10,836	11,358
Arrears	0	1,349	1,467	2,000	2,000	2,000	3,000	3,000
Development expenditure	11,787	20,999	25,119	34,791	32,809	47,732	49,110	58,109
Part I (foreign financed)	9,521	17,681	22,706	30,972	28,817	40,673	39,882	47,608
Part II (domestically financed)	2,266	3,319	2,413	3,819	3,992	7,059	9,228	10,502
Net lending	61	0	589	0	0	690	0	0
Overall balance (including grants)	-18,637	-14,719	-12,595	-5,448	-5,442	-4,373	-1,656	151
Spending directly related to privatization 1/	0	0	0	2,225	2,752	0	0	0
Augmented balance (incl. privatization)	-18,637	-14,719	-12,595	-7,673	-8,194	-4,373	-1,656	151
Total financing	18,099	14,938	11,805	7,673	11,518	4,373	1,656	-151
Foreign (net)	-730	425	4,986	5,773	6,354	5,737	8,221	10,871
Borrowing	4,917	7,185	11,588	15,817	16,119	11,828	13,181	15,539
Program	0	1,386	5,182	3,351	3,373	1,217	2,816	4,607
Project	4,917	5,799	6,406	12,467	12,746	10,611	10,366	10,933
Amortization	-5,448	-7,577	-8,210	-10,044	-9,764	-6,090	-4,960	-4,669
Domestic (net)	18,829	14,512	6,818	-1,661	1,081	-1,364	-6,566	-11,022
Banking system	13,922	6,601	4,018	-4,535	-2,665	...	...	...
Nonbanks	5,213	7,850	2,800	2,874	3,746	...	...	...
Privatization and other financing	-307	62	0	3,560	4,083	0	0	0
Discrepancy (- is overfinancing)	538	-218	790	0	-3,324	0	0	0
Memorandum items:								
Nominal GDP	160,137	189,563	226,479	270,989	274,634	324,355	369,105	420,061
Net domestic debt	32,654	47,104	53,923	52,262	55,004	53,639	47,074	36,052
Underlying balance 2/	-2,781	-1,648	5,304	4,805	-440	3,208	2,290	1,492
Overall balance (excluding grants)	-29,312	-37,783	-40,861	-56,478	-58,235	-61,532	-56,168	-63,027
Pro-poor spending	11,244	12,512	14,865	25,172	35,019	...	...	...
Arrears (stock)	...	...	10,037	...	...	...	...	...
MDRI debt stock relief, World Bank	...	...	...	...	...	254,959	...	...
MDRI debt service relief, World Bank	...	...	...	...	...	3,423	4,267	4,491
MDRI debt stock relief, AfDB	...	...	...	...	...	55,604	...	...
MDRI debt service relief, AfDB	...	...	...	...	...	368	493	519

Sources: Malawian authorities; and IMF staff estimates.

1/ Includes 2005/06 transactions related to the sale of MTL: retrenchment costs and the capital injection less debt repayment.

2/ The underlying balance is a measure of domestic adjustment effort, specifically the domestic primary balance, excluding maize operations and the Health SWAp. Definition: Overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize and the Health SWAp, plus foreign-financed development expenditures.

Table 2c. Malawi: Central Government Operations, 2002/03 – 2008/09
(In percent of GDP)

	2002/03	2003/04	2004/05	2005/06		2006/07	2007/08	2008/09
	Act.	Act.	Est.	Prog.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	26.7	34.7	37.6	43.3	44.1	41.8	39.0	38.7
Revenue	20.0	22.6	25.1	24.5	24.9	24.2	24.2	23.7
Tax revenue	17.0	19.5	22.0	21.4	21.8	21.3	21.3	20.9
Pension contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	3.0	3.1	3.1	3.1	3.1	2.8	2.9	2.8
<i>of which</i> : Sales receipts maize	0.4	0.7	0.2	0.4	0.6	0.2	0.4	0.4
Grants	6.7	12.2	12.5	18.8	19.2	17.6	14.8	15.0
Budget/ Program support	0.8	3.5	2.2	5.6	5.2	3.0	3.4	3.6
Project	2.9	3.4	4.9	5.6	4.7	7.5	6.3	8.7
Dedicated grants	0.1	2.2	3.1	5.0	6.5	4.5	3.3	1.5
HIPC debt relief	2.2	2.8	2.2	2.6	2.8	1.6	1.2	1.0
MDRI debt relief from IMF	0.0	0.0	0.0	0.0	0.0	1.1	0.5	0.3
Total expenditure and net lending	38.3	42.5	43.1	45.3	46.1	43.1	39.4	38.7
Current expenditure	30.9	31.4	31.8	32.5	34.1	28.2	26.1	24.9
Wages and salaries	6.8	6.5	7.5	7.5	7.4	7.2	7.2	7.2
<i>Of which</i> : Health SWAp	0.0	0.0	0.0	0.3	0.3	0.3	0.3	0.3
Interest payments	6.9	10.6	8.7	6.8	6.6	4.8	3.4	2.6
Domestic	5.5	9.1	7.4	5.5	5.4	4.3	3.1	2.2
Foreign	1.3	1.5	1.3	1.3	1.2	0.6	0.4	0.4
Other current expenditure	17.2	14.3	15.6	18.2	20.1	16.2	15.5	15.1
Purchases of goods and services	12.6	9.7	8.9	11.0	12.2	9.1	8.2	8.5
Maize purchases	3.8	0.0	1.1	3.1	3.3	0.6	0.4	0.4
Pulses and oils	0.0	0.0	0.0	0.0	0.5	0.0	0.0	0.0
Health SWAp	0.0	0.0	0.4	1.4	1.7	1.9	1.3	1.2
Elections	0.0	1.1	0.0	0.1	0.2	0.3	0.1	0.5
Other goods and services	8.8	8.6	7.4	6.4	6.5	6.3	6.5	6.5
Subsidies and other current transfers	4.6	3.9	6.0	6.4	7.2	6.5	6.4	5.9
Pension and gratuities	0.9	0.9	0.9	1.2	1.2	1.5	1.7	1.7
Fertilizer/Seeds subsidy	0.0	0.0	1.9	2.1	2.6	2.4	1.8	1.5
Other subsidies and transfers	3.7	3.1	3.1	3.1	3.4	2.6	2.9	2.7
Arrears	0.0	0.7	0.6	0.7	0.7	0.6	0.8	0.7
Development expenditure	7.4	11.1	11.1	12.8	11.9	14.7	13.3	13.8
Part I (foreign financed)	5.9	9.3	10.0	11.4	10.5	12.5	10.8	11.3
Part II (domestically financed)	1.4	1.8	1.1	1.4	1.5	2.2	2.5	2.5
Net lending	0.0	0.0	0.3	0.0	0.0	0.2	0.0	0.0
Overall balance (including grants)	-11.6	-7.8	-5.6	-2.0	-2.0	-1.3	-0.4	0.0
Spending directly related to privatization 1/	0.0	0.0	0.0	0.8	1.0	0.0	0.0	0.0
Augmented balance	-11.6	-7.8	-5.6	-2.8	-3.0	-1.3	-0.4	0.0
Total financing	11.3	7.9	5.2	2.8	4.2	1.3	0.4	0.0
Foreign (net)	-0.5	0.2	2.2	2.1	2.3	1.8	2.2	2.6
Borrowing	3.1	3.8	5.1	5.8	5.9	3.6	3.6	3.7
Program	0.0	0.7	2.3	1.2	1.2	0.4	0.8	1.1
Project	3.1	3.1	2.8	4.6	4.6	3.3	2.8	2.6
Amortization	-3.4	-4.0	-3.6	-3.7	-3.6	-1.9	-1.3	-1.1
Domestic (net)	11.8	7.7	3.0	-0.6	0.4	-0.4	-1.8	-2.6
Financial instruments	11.9	7.6	3.0	-0.6	0.4	-0.4	-1.8	-2.6
Banking system	8.7	3.5	1.8	-1.7	-1.0	...	...	...
Nonbanks	3.3	4.1	1.2	1.1	1.4	...	...	...
Privatization and other financing	-0.2	0.0	0.0	1.3	1.5	0.0	0.0	0.0
Discrepancy (- is overfinancing)	0.3	-0.1	0.3	0.0	-1.2	0.0	0.0	0.0
Memorandum items:								
Net domestic debt	20.4	24.8	23.8	19.3	20.0	16.5	12.8	8.6
Underlying balance 2/	-1.7	-0.9	2.3	1.8	-0.2	1.0	0.6	0.4
Overall balance (excluding grants)	-18.3	-19.9	-18.0	-20.8	-21.2	-19.0	-15.2	-15.0
Pro-poor spending	7.0	6.6	6.6	9.3	12.8	...	...	...
Arrears (Stock)	...	...	4.4	...	...	...	...	...
MDRI debt stock relief, World Bank	...	...	...	...	...	78.6	...	...
MDRI debt service relief, World bank	...	...	...	...	...	1.1	1.2	1.1
MDRI debt stock relief, AfDB	...	...	...	...	...	17.1	...	...
MDRI debt service relief, AfDB	...	...	...	...	...	0.1	0.1	0.1

Sources: Malawian authorities; and IMF staff estimates.

1/ Includes for 2005/06 transactions related to the sale of MTL: retrenchment costs and the capital injection less debt repayment.

2/ The underlying balance is a measure of domestic adjustment effort, specifically the domestic primary balance, excluding maize operations and the Health SWAp. Definition: Overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize and the Health SWAp, plus foreign-financed development expenditures.

Table 3a. Malawi : Monetary Authorities' Balance Sheet, 2004-06
(In millions of Malawi kwacha, unless otherwise indicated)

	2004				2005				2006				
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q3	Q4	
	Act.	Act.	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	
Reserve money	16,728	17,967	16,196	19,580	20,894	20,115	20,904	20,610	17,890	17,500	20,194	21,163	22,067
Currency outside banks	11,505	10,993	9,976	13,050	...	12,785	...	11,946	...	11,793	...	...	...
Cash in vault	1,440	1,861	1,567	1,866	...	1,787	...	2,331	...	1,915	...	...	...
Commercial bank deposits with RBM	3,782	5,114	4,653	4,664	...	5,543	...	6,333	...	3,793	...	...	...
Net foreign assets (NFA)	3,369	2,919	158	4,060	8,507	9,142	7,223	6,915	3,935	3,455	7,606	12,844	9,187
NFA (millions of U.S. dollars)	30.9	26.8	1.4	33.0	69.2	73.7	58.7	55.9	32.0	25.8	61.8	104.4	74.7
Gross foreign assets	123.7	119.3	90.4	112.4	163.8	159.4	142.2	131.1	109.6	108.3	137.2	133.4	113.9
Foreign liabilities	-92.8	-92.5	-88.9	-79.4	-94.6	-85.8	-83.5	-75.3	-77.6	-82.5	-75.4	-28.9	-39.2
Net domestic assets	13,359	15,048	16,038	15,520	12,387	10,972	13,681	13,695	13,955	14,045	12,943	8,319	12,880
Credit to government (net)	11,237	12,046	20,297	22,181	19,415	11,957	20,376	11,393	13,006	12,706	9,647	10,877	12,504
Credit to statutory bodies (net)	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to domestic banks	2	2	2	2	3	2	2	2	2	2	2	2	2
Other items (net)	2,120	3,001	-4,261	-6,662	-7,031	-986	-6,697	2,299	947	1,337	3,294	-2,560	374
Revaluation accounts	59	-2	0	0	0	0	0	0	0	112	0	112	112
Open market operations	-5,937	-5,582	-13,592	-16,907	-17,441	-10,061	-17,483	-7,881	-7,266	-6,088	-6,621	-5,140	-4,445
Encumbered reserves	1,013	1,013	1,037	799	800	807	800	3,472	492	869	492	492	492
IMF MDRI Relief	...	...	...	...	...	...	...	...	...	...	...	...	...
Others	6,985	7,572	8,293	9,446	9,611	8,268	9,987	6,709	7,721	6,444	8,658	7,348	9,610
Memorandum items:													
Seasonally adjusted reserve money	16,380	17,761	19,474	19,382	20,060	19,813	20,847	20,428	21,636	21,074	19,989	20,846	21,872
Quarterly change	-11.7	8.4	9.6	-0.5	2.4	2.2	3.9	3.1	5.5	3.2	4.7	-5.1	4.9
Annual change	...	30.8	34.4	4.5	24.9	21.0	16.3	15.0	10.5	8.2	16.2	3.1	7.1
Seasonally adjusted currency outside banks	10,764	11,562	11,872	11,783	...	11,950	...	12,530	...	14,050	...	...	...
Quarterly change	8.0	7.4	2.7	-0.7	...	1.4	...	4.9	...	12.1	...	...	...
Annual change	...	39.7	38.7	18.2	...	11.0	...	8.4	...	18.3	...	...	...
Money multiplier	...	...	...	...	...	...	...	...	...	...	...	...	...
Money multiplier	2.60	2.54	2.75	2.59	2.51	2.54	2.54	2.53	2.81	3.09	2.63	2.91	2.89
Seasonally adjusted	2.62	2.52	2.47	2.50	2.55	2.51	2.55	2.53	2.55	2.71	2.55	2.88	2.88
Net sales 1/	...	...	...	...	...	...	...	...	...	...	...	...	...
Quarterly change	6,643	-2,254	6,029	2,177	2,517	1,733	-735	-60	-1,978	3,840	-2,092	1,375	80
Annual change	...	7,378	12,086	12,595	8,257	7,686	9,776	9,879	1,890	7,690	-2,379	1,007	1,148

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

1/ Defined as the increase in holdings at cost value of both treasury and RBM bills in the private sector.

Table 3b. Malawi : Monetary Survey, 2004-06
(In millions of Malawi kwacha, unless otherwise indicated)

	2004				2005				2006											
	Q3		Q4		Q1		Q2		Q3		Q4		Q1		Q2		Q3		Q4	
	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.
Money and quasi-money	43,452	45,666	44,552	50,625	52,347	51,081	53,010	52,207	50,331	54,079	59,740	60,078	61,644	63,724						
Money	24,556	25,443	24,400	28,977	...	29,171	...	30,203	...	29,941	...	...	...	...		
Quasi money	18,896	20,222	20,151	21,648	...	21,910	...	22,004	...	24,138	...	...	...	...		
Of which: foreign currency deposits	7,501	7,120	7,284	8,246	...	7,564	...	6,475	...	9,300	...	...	...	...		
Net foreign assets (NFA)	9,358	7,593	3,092	9,054	13,083	12,475	12,512	9,896	7,711	9,417	13,227	11,396	17,789	13,209						
NFA (millions of U.S. dollars)	85.9	69.7	27.7	73.6	106.4	100.5	101.7	80.0	62.7	70.4	107.5	92.7	144.6	107.4						
Gross foreign assets	200.1	177.8	125.2	163.9	211.6	207.5	199.4	170.0	157.2	163.1	199.8	166.8	181.8	156.3						
Foreign liabilities	-114.2	-108.1	-97.5	-90.3	-105.2	-106.9	-97.7	-90.1	-94.5	-92.7	-92.3	-74.1	-37.1	-48.9						
Monetary authorities	3,369	2,919	158	4,060	8,507	9,142	7,223	6,915	3,935	3,455	7,606	7,251	12,844	9,187						
NFA of the monetary authorities (millions of U.S. dollars)	30.9	26.8	1.4	33.0	69.2	73.7	58.7	55.9	32.0	25.8	61.8	59.0	104.4	74.7						
Gross foreign assets	123.7	119.3	90.4	112.4	163.8	159.4	142.2	131.1	109.6	108.3	137.2	126.4	133.4	113.9						
Foreign liabilities	-92.8	-92.5	-88.9	-79.4	-94.6	-85.8	-83.5	-75.3	-77.6	-82.5	-75.4	-67.4	-28.9	-39.2						
Commercial banks	5,989	4,674	2,934	4,994	4,576	3,333	5,289	2,982	3,776	5,962	5,621	4,145	4,945	4,022						
NFA of the commercial banks (millions of U.S. dollars)	55.0	42.9	26.3	40.6	37.2	26.9	43.0	24.1	30.7	44.6	45.7	33.7	40.2	32.7						
Gross foreign assets	76.5	58.5	34.8	51.5	47.8	48.0	57.2	38.9	47.6	54.7	62.6	40.4	48.4	42.4						
Foreign liabilities	-21.5	-15.6	-8.5	-10.9	-10.6	-21.2	-14.2	-14.8	-16.9	-10.2	-16.9	-6.7	-8.2	-9.7						
Net domestic assets	34,094	38,073	41,460	41,571	39,264	38,607	40,498	42,311	42,620	44,661	46,513	48,682	43,855	50,515						
Credit to government (net)	23,232	22,322	29,229	30,077	30,104	21,083	30,288	23,335	25,447	29,261	25,542	27,695	28,364	36,394						
Credit to statutory bodies (net)	-606	-483	-664	-772	-879	-1,088	-694	-1,479	-1,200	-1,370	-1,252	-1,379	-1,449	-1,522						
Credit to private sector	11,942	13,926	13,227	16,497	15,325	18,201	16,356	17,500	17,903	16,500	20,121	19,766	20,335	15,391						
Other items (net)	-474	2,307	-332	-4,231	-5,287	411	-5,453	2,955	470	270	2,102	2,600	-3,395	251						
RBM's revaluation accounts	59	-2	0	0	0	0	0	0	0	112	0	112	112	112						
Open market operations	-5,639	-5,372	-7,510	-10,174	-12,304	-6,461	-12,846	-4,831	-5,614	-3,438	-4,969	-1,634	-2,257	-850						
Encumbered reserves	1,013	1,013	1,037	799	800	807	800	3,472	492	869	492	492	492	492						
IMF MDRI Relief	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Others	4,092	6,668	6,141	5,144	6,218	6,065	6,594	4,314	5,592	2,727	6,579	3,631	4,727	5,893						
Memorandum items:																				
Seasonally adjusted broad money	42,659	45,616	47,310	48,585	50,749	50,211	52,950	52,144	54,546	57,271	56,892	57,657	60,594	63,648						
Quarterly change	4.2	6.9	3.7	2.7	4.3	3.3	4.3	3.9	4.3	9.8	4.3	0.7	5.1	5.0						
Annual change	...	29.7	23.8	18.6	20.5	17.7	16.1	14.3	13.0	21.1	18.0	18.7	20.7	22.1						
Seasonally adjusted credit to private sector	11,975	13,651	13,893	16,744	15,594	18,274	15,906	17,189	18,652	17,430	20,516	20,062	20,416	15,118						
Quarterly change	12.6	14.0	1.8	20.5	2.0	9.1	2.0	-5.9	10.0	1.4	10.0	15.1	1.8	-26.0						
Annual change	...	42.6	40.2	57.4	28.3	52.6	17.4	25.9	35.4	25.5	22.0	19.8	11.7	-12.1						
Velocity of money (annual GDP divided by seasonally adjusted end-period broad money)	4.65	4.54	4.58	4.66	4.57	4.70	4.55	4.71	4.73	4.54	4.76	4.76	4.76	4.77						

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

Table 4a. Malawi: Balance of Payments, 2002–09 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2002	2003	2004	2005	2006		2007	2008	2009
	Act.	Act.	Act.	Act.	Prog.	Proj.	Proj.	Proj.	Proj.
Current account balance (including grants)	-216.2	-134.2	-177.5	-121.9	-98.6	-169.5	-42.1	-26.7	-66.7
Merchandise trade balance	-305.7	-351.0	-423.9	-473.4	-429.2	-497.8	-455.7	-437.8	-510.7
Exports	421.1	440.6	470.0	524.2	557.6	572.0	592.9	611.4	630.3
<i>Of which: Tobacco</i>	232.7	205.6	229.5	266.6	296.9	295.1	303.4	312.0	321.3
Imports	-726.8	-791.6	-893.9	-997.6	-986.8	-1069.8	-1048.6	-1049.2	-1141.0
<i>Of which: Petroleum</i>	-63.0	-78.5	-95.9	-137.2	-156.3	-177.5	-187.9	-186.9	-190.2
Emergency Maize	-102.8	-5.5	0.0	-63.7	-6.0	-40.0	0.0	0.0	0.0
Services balance	-154.0	-88.2	-84.7	-83.9	-90.4	-84.6	-74.5	-76.4	-72.2
Interest public sector (net)	-20.2	-25.5	-27.7	-25.6	-24.8	-18.9	-3.6	-0.8	8.4
Receipts	2.5	1.5	0.7	0.7	3.7	3.0	5.3	9.1	14.4
Payments (amounts due before HIPC debt relief)	-22.7	-27.0	-28.4	-26.3	-28.5	-22.0	-8.9	-9.8	-6.1
Other factor payments (net)	-24.5	-16.1	-16.9	-17.2	-18.6	-18.7	-19.7	-20.9	-22.2
Nonfactor (net)	-109.3	-46.6	-40.1	-41.0	-47.0	-47.0	-51.2	-54.7	-58.4
Receipts	49.7	40.0	40.6	41.5	42.2	42.5	43.4	45.5	47.8
Payments	-76.6	-86.6	-80.7	-82.5	-89.2	-89.5	-94.6	-100.2	-106.3
Maize-related payments	-82.4								
Unrequited transfers (net)	243.4	305.1	331.0	435.4	420.9	412.9	488.1	487.4	516.3
Private (net)	8.1	141.1	117.6	151.3	130.7	132.5	136.4	139.4	145.3
Receipts	21.6	156.4	127.8	161.6	141.2	143.0	147.3	150.5	156.6
Payments	-13.4	-15.3	-10.2	-10.4	-10.6	-10.6	-10.8	-11.1	-11.3
Official (net)	235.3	164.0	213.4	284.1	290.2	280.5	351.7	348.0	371.0
Receipts	235.3	164.0	213.4	284.1	290.2	280.5	351.7	348.0	371.0
Balance of payments assistance	12.8	41.7	64.3	97.2	81.8	46.1	98.9	92.1	98.2
Japan HIPC Initiative 2/	11.0	16.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Donor humanitarian grants	135.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project related	76.1	87.5	149.2	172.8	208.5	234.4	252.7	255.8	272.8
Drought related	0.0	0.0	0.0	14.1	0.0	0.0	0.0	0.0	0.0
Food Security	0.0	18.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account balance (incl. errors and omissions)	61.4	95.9	152.2	92.1	75.0	111.2	89.1	90.3	107.5
Medium- and long-term flows	23.8	10.9	16.2	21.0	52.9	50.0	58.9	56.5	71.6
Disbursements	81.0	96.7	95.3	97.5	136.9	113.3	90.8	85.9	99.9
Balance of payments support	0.0	18.4	35.2	18.1	56.5	32.9	18.4	23.6	27.5
Project support	81.0	78.3	50.1	79.4	80.4	80.4	72.4	62.3	72.4
Other medium-term loans			10.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment assets	0.0	-17.2	-4.3	0.0	0.0	0.0	0.0	0.0	0.0
Amortization (amounts due before HIPC debt relief)	-57.2	-68.6	-74.8	-76.5	-84.0	-63.4	-31.9	-29.4	-28.2
Foreign direct investment and other inflows	37.6	43.2	44.1	26.5	29.8	29.8	32.3	34.0	35.7
MDRI debt forgiveness on debt due after current year						1844.0	375.7		
Other liabilities (MDRI-IDA and ADF loans)						-1812.7	-377.9		
Short-term capital and errors and omissions	0.0	41.8	91.9	44.6	-7.6	0.0	0	0	0
Overall balance	-154.8	-38.2	-25.3	-29.8	-23.6	-58.3	46.9	63.6	40.8
Financing (- increase in reserves)	154.8	38.2	25.4	29.9	23.6	58.3	-46.9	-63.6	-40.8
Central bank	111.5	-2.6	-15.7	-48.6	-30.8	6.0	-75.1	-85.5	-62.8
Gross reserves (- increase)	40.9	39.4	-6.0	-30.6	-28.8	41.3	-92.7	-92.8	-62.8
Liabilities	70.6	-42.0	-9.7	-18.0	-1.9	-35.3	17.6	7.3	0.0
<i>Of which: IMF (net)</i>	16.8	-0.1	-13.7	-10.6	-2.1	10.6	17.5	7.3	0.0
Purchases/drawings	23.0	9.3	0.0	8.3	25.3	24.9	17.5	7.3	0.0
Repurchases/repayments	-6.2	-9.3	-13.7	-18.9	-27.3	-14.2	0.0	0.0	0.0
MDRI liabilities (repayment)	50.0	-50.0	0.0	0.0	0.0	-54.2	0.0	0.0	0.0
Commercial banks	14.5	-6.7	-6.0	18.8	-1.5	-8.6	-4.0	-4.0	-5.0
Arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	28.9	47.5	47.0	59.7	55.9	46.2	29.9	25.9	27.0
MDRI debt forgiveness on debt due in current year						14.6	2.2		
Residual financing gap (+ underfinanced)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
IMF MDRI debt relief	0.0	0.0	0.0	0.0	0.0	13.2	20.7	8.3	6.4
Gross official reserves									
Millions of U.S. dollars	162.0	122.6	128.6	159.2	187.6	117.9	210.5	303.3	366.1
Months of imports 3/	2.2	1.5	1.4	1.8	2.0	1.2	2.2	2.9	3.3
In months of imports 4/	2.4	1.7	1.6	1.8	2.1	1.2	2.2	3.2	3.5
Usable gross official reserves 5/									
Millions of U.S. dollars	103.4	115.6	119.3	131.2	183.2	113.9	206.5	299.3	362.1
Months of imports 3/	1.4	1.4	1.3	1.4	2.0	1.2	2.2	2.9	3.3
Months of imports 4/	1.5	1.6	1.5	1.5	2.0	1.2	2.2	3.1	3.5
Current account balance (percent of GDP)									
Excluding official transfers	-23.3	-16.9	-20.5	-19.6	-18.1	-20.5	-17.1	-15.1	-16.3
Including official transfers	-11.2	-7.6	-9.3	-5.9	-4.6	-7.7	-1.8	-1.1	-2.5
Export value growth (percent)	-1.3	4.6	6.7	11.5	8.4	11.2	6.3	3.1	3.1
Merchandise imports, excluding all maize	-595	-786	-876	-934	-981	-1030	-1049	-1049	-1141
Merchandise import value, excluding maize, percent change	3.3	32.1	11.5	6.6	-2.8	10.3	1.8	0.1	8.7

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

1/ The implications of MDRI were incorporated before the DSA was completed and may therefore differ from the figures presented in the HIPC completion point document.

2/ For 2002-03, relief was provided through grants in yen. From 2004 onward, debt will be written off and recorded under debt relief.

3/ In months of following year's imports of goods and nonfactor services.

4/ In months of current year's imports of goods and nonfactor services.

5/ Excludes open letter of credit, blocked deposits, and reserves pledged.

Table 4b. Malawi: Gross Financing Requirements and Sources of Financing, 2002–09
(In millions of U.S. dollars)

	2002 Act.	2003 Act.	2004 Act.	2005 Act.	2006		2007 Proj.	2008 Proj.	2009 Proj.
					Prog.	Proj.			
Gross financing requirements	-405.7	-385.3	-487.4	-520.7	-530.5	-2353.4	-900.2	-500.8	-533.7
External current account deficit (excl. official transfers) <i>of which:</i> trade balance on goods and services	-451.6 -415.0	-298.1 -397.7	-391.0 -464.0	-406.0 -514.4	-388.9 -476.2	-449.9 -544.8	-393.8 -506.9	-374.7 -492.4	-437.7 -569.1
Official debt amortization of which IMF repurchases and repayments MDRI debt repayment	-63.4 -6.2	-77.9 -9.3	-88.5 -13.7	-95.4 -18.9	-111.3 -27.3	-1890.3 -14.2 -1812.7	-409.7 0.0 -377.9	-29.4 0.0	-28.2 0.0
Other , including reserves Gross reserves Gross liabilities (excluding IMF) Change in n.f.a. of commercial banks	109.2 40.9 53.8 14.5	-9.2 39.4 -41.9 -6.7	-8.0 -6.0 4.0 -6.0	-19.2 -30.6 -7.4 18.8	-30.2 -28.8 0.1 -1.5	-13.2 41.3 -45.9 -8.6	-96.6 -92.7 0.0 -4.0	-96.8 -92.8 0.0 -4.0	-67.8 -62.8 0.0 -5.0
Sources of financing	405.8	385.3	487.5	520.7	530.5	2338.8	898.0	500.8	533.7
Private capital (net) <i>of which</i> Short term errors and omissions	37.6 0.0	67.8 41.8	131.7 91.9	71.1 44.6	22.2 -7.6	29.8 0.0	32.3 0.0	33.8 -0.2	35.9 0.2
Gross official Assistance Official Grants Balance of payments support Other Loan Disbursements IMF Balance of payments support Project support Other medium-term loans	339.3 235.3 12.8 222.5 104.0 23.0 0.0 81.0 0.0	270.0 164.0 41.7 122.3 106.0 9.3 18.4 78.3 0.0	308.8 213.4 64.3 149.2 95.3 0.0 35.2 50.1 10.0	389.9 284.1 97.2 186.9 105.8 8.3 18.1 79.4 0.0	452.4 290.2 81.8 208.5 162.2 25.3 56.5 80.4 0.0	418.7 280.5 46.1 234.4 138.2 24.9 32.9 80.4 0.0	460.0 351.7 98.9 252.7 108.3 17.5 18.4 72.4 0.0	441.2 348.0 92.1 255.8 93.2 7.3 23.6 62.3 0.0	470.9 371.0 98.2 272.8 99.9 0.0 27.5 72.4 0.0
Accumulation of arrears (exceptional)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief (including MDRI)	28.9	47.5	47.0	59.7	55.9	1890.3	405.6	25.9	27.0
Financing gap (surplus +/-deficit -)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items (percent of GDP)									
Gross financing requirements	-20.9	-21.7	-25.6	-25.0	-24.6	-107.1	-39.1	-20.1	-19.8
Current account balance, excluding official transfers	-23.3	-16.8	-20.5	-19.5	-18.0	-20.5	-17.1	-15.1	-16.3
Trade balance on goods and services	-21.4	-22.4	-24.4	-24.7	-22.1	-24.8	-22.0	-19.8	-21.2
Gross official assistance	17.5	15.2	16.2	18.7	21.0	19.0	20.0	17.7	17.5
Gross official assistance, net of amortization after debt relief	15.7	13.5	14.0	17.0	18.4	19.0	19.8	17.6	17.5
Balance of payments assistance (including IMF)	1.8	3.9	5.2	5.9	7.6	4.7	5.9	4.9	4.7
Financing gap	0.0	0.0	0.0	0.0	0.0	-0.7	-0.1	0.0	0.0

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

Table 5a. Malawi: Quantitative Targets, June 2005-March 2006 1/
(Cumulative flows from June 30, 2005)

Criteria	Jun. 2005		End-Sep. 2005		City. Rept. 05/285		Actual		City. Rept. 05/285		Adjusted Target		City. Rept. 06/94		Adjusted Target	
	Stock	Actual	Adj. Target	Actual	Adj. Target	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual
I. Monetary Targets (Millions of Malawi kwacha)																
1. Ceiling on net domestic assets of the monetary authorities 2/	15,520	-3,133	0	-3,133	-4,466	-1,839	2,070	231	-1,781	-1,564	-1,278	-2,842	-1,197			
2. Ceiling on reserve money	19,580	1,314	...	1,314	534.1	1,324	...	1,324	1,029	-1,690	...	-1,690	-2,080			
II. Fiscal Targets (Millions of Malawi kwacha)																
3. Ceiling on central government's net domestic borrowing 2/ 4/ 5/	53,923	-783	-188	-971	-1,644	-599	1,578	979	-88	180	474	653	6,857			
4. Ceiling on central government wages and salaries 4/	...	4,848	-38	4,809	4,802.3	9,934	-21	9,913	9,592	14,914	174	15,087	15,356			
5. Ceiling on central government discretionary expenditures 4/	...	15,123	401	15,524	12,311.3	29,424	-844	28,580	29,768	40,873	-387	40,486	47,078			
III. External Targets (Millions of U.S. dollars)																
6. Floor on net foreign assets of the monetary authorities 2/	33.0	36.1	0.0	36.1	40.7	25.7	-16.8	8.9	22.9	-1.0	-10.0	-11.0	-7.2			
7. Ceiling on the accumulation of external payments arrears 6/	...	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0			
8. Ceiling on new nonconcessional external debt with a maturity of one year or more 6/	...	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0			
9. Ceiling on new nonconcessional external debt with a maturity of less than one year 6/	...	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0			
Memorandum items (Millions of Malawi kwacha):																
Balance of payments support (In millions of U.S. dollars)		60.2	0.0	...	35.7	105.2	-16.8	...	88.4	116.4	-10.0	...	91.4			
Health SWAp wage expenditures		177	-38	...	138.2	358	-21	...	337	322	174	...	496			
Health SWAp ORT expenditures		1,016	401	...	1,417.4	2,062	-844	...	1,218	2,399	-387	...	2,011			
Net Movement in special accounts		-269	-188	...	-81	678	-502	...	1,180	1,049	-783	...	1,832			
Net movement in NAC account		0	313	...	-312.8	0	91	...	-91	-368	-35	...	-333			
Maize revenue		170	-130	...	299.57	504	-249	...	753	1,157	106	...	1,051			
Net movement in Health SWAp account		-439	-371	...	-67.6	174	-343	...	517	259	-853	...	1,113			
Swap receipts		754	...	...	1,495.6	2,594	...	...	2,081	2,980	...	...	3,656			
Swap payments		-1,193	...	...	-1,563.2	-2,420	...	...	-1,563	-2,721	...	...	-2,543			
Cash payment of arrears		500	0	...	636.70	1,000	0	...	1,536	1,604	0	...	1,969			
Liquidity Reserve Requirement		27.5	0	...	27.5	27.5	0	...	27.5	27.5	2,508	...	20.0			
Program exchange rate	123	123	123	123	123	123	123	123	123	123	123	123	123	123	123	123

PC - performance criteria; IT - indicative target

- 1/ Targets are defined in the technical memorandum of understanding (TMU).
- 2/ Targets are subject to an adjuster for BOP support.
- 3/ Targets for end-March are indicative.
- 4/ Targets are subject to an adjuster for donor-funded health expenditures.
- 5/ Targets are subject to adjusters for maize revenue and cash payment of arrears.
- 6/ Evaluated on a continuous basis.

Table 5b. Malawi: Quantitative Targets, June 2006-December 2006 1/
(Cumulative flows from June 30 2005)

Criteria	Jun. 2005 Stock Actual	End-Jun. 2006: Test Date		End-Sep. 2006		End-Dec. 2006: Test Date
		Country Report 06/04	Proj.	Target	Target	
(Cumulative flows from June 30, 2005)						
I. Monetary Targets (Millions of Malawi kwacha)						
1. Ceiling on net domestic assets of the monetary authorities 2/	15,520	-375	-2,577	-7,201	-2,640	
2. Ceiling on reserve money	19,580	3,170	613	1,582	2,486	
II. Fiscal Targets (Millions of Malawi kwacha)						
3. Ceiling on central government's net domestic borrowing 2/ 4/ 5/	53,923	-1,661	1,081	3,206	6,010	
4. Ceiling on central government wages and salaries 4/	...	20,448	20,448	26,158	31,956	
5. Ceiling on central government discretionary expenditures 4/	...	53,054	59,209	73,897	90,413	
III. External Targets (Millions of U.S. dollars)						
6. Floor on net foreign assets of the monetary authorities 2/	33.0	28.8	25.9	71.4	41.7	
7. Ceiling on the accumulation of external payments arrears 6/	...	0.0	0.0	0.0	0.0	
8. Ceiling on new nonconcessional external debt with a maturity of one year or more 6/	...	0.0	0.0	0.0	0.0	
9. Ceiling on new nonconcessional external debt with a maturity of less than one year 6/	...	0.0	0.0	0.0	0.0	
Memorandum items (Millions of Malawi kwacha):						
Balance of payments support (in millions of U.S. dollars)		144.5	137.8	159.0	167.4	
Debt service payments to the WB and the ADB				7.0	0.4	
IMF debt relief transfers from the RBM to the CG				4.5	8.7	
Health SWAp wage expenditures		730	730	977	1,230	
Health SWAp ORT expenditures		3,873	4,660	4,413	7,050	
Net Movement in special accounts		1,693	1,387	3,590	1,915	
Net movement in NAC account		0	0	0	0	
Maize revenue		1,157	1,051	1,091	1,411	
Net movement in Health SWAp account		536	335	2,498	503	
Swap receipts		5,139	5,792	7,955	8,883	
Swap payments		-4,603	-5,457	-5,457	-8,379	
Cash payment of arrears		2,000	2,000	2,500	3,000	
Liquidity Reserve Requirement		27.5	20.0	20.0	20.0	
Program exchange rate	123	123	123	123	123	

PC - performance criteria; IT - indicative target

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

2/ Targets are subject to an adjuster for BOP support.

3/ Targets for end-September are indicative.

4/ Targets are subject to an adjuster for donor-funded health expenditures.

5/ Targets are subject to adjusters for maize revenue and cash payment of arrears.

6/ Evaluated on a continuous basis.

Table 5c. Malawi: Proposed Prior Actions, Structural Performance Criteria and Benchmarks
December 2005–December 2006

Number	Description	Date	Status
Prior Actions for completion of the Second Review under the PRGF arrangement			
1	Parliament approval of 2006/07 budget in line with macroeconomic framework specified in the TMU (para. 34)	August 2006	Implemented
2	Implement adjustment formula to the current pension system. (TMU para 35)		
Performance Criteria			
1	Make budget ceilings module in payment system fully operational (TMU, para. 36)	End-Dec. 2005	Not implemented
2	Develop and implement new travel policy, which includes mechanisms for monitoring adherence (TMU, para. 37).	End-Mar. 2006	Not implemented
Structural Benchmarks			
1	Develop detailed schedule of wage adjustments by grade for 2005/06	End-Sep. 2005	Implemented in February 2006
2	Publish monthly fiscal reports with one month lag (TMU, para. 38)	End-Dec. 2005	Implemented with a delay
3	Prepare quarterly reports (with one month lag) on status of arrears.(TMU para. 38)	End-Dec. 2005	Implemented with a delay
4	Strengthen cash management and expenditure monitoring procedures by preparing reports as indicated in the TMU (para. 40)	End-Mar. 2006	Not implemented
5	Complete impact analysis of tighter credit quality classifications on commercial bank balance sheets (TMU, para. 39)	End-Mar. 2006	Implemented
6	Reduce import backlog of commercial bank foreign exchange applications for import-related payments, as defined in the TMU (para. 46)	End-Mar. 2006	Implemented
7	Eliminate import backlog of commercial bank foreign exchange applications for import-related payments (TMU para. 46)	End-Jun. 2006	Implemented
8	Develop and implement new travel policy, which includes mechanisms for monitoring adherence (TMU, para. 37)	End-Sept 2006	
9	Formulate an action plan to address weaknesses in the area of PFM (TMU para. 45)	End-Oct. 2006	

Table 6a: Malawi: Schedule of Disbursements Under the Three-Year PRGF Arrangement
(In million of SDRs)

Amount	Date	Conditions Necessary for Disbursement
5.4190	Aug-05	Executive Board approval of three-year PRGF arrangement
4.9245	Feb-06	Completion of 1st review and observance of end-Sep. 2005 PCs
4.9245	Aug-06	Completion of 2nd review and observance of end-Dec. 2005 PCs
6.6800	Dec-06	Completion of 3rd review and observance of end-Jun. 2006 PCs
6.6800	May-07	Completion of 4th review and observance of end-Dec. 2006 PCs
4.7710	Nov-07	Completion of 5th review and observance of end-Jun. 2007 PCs
4.7710	May-08	Completion of 6th review and observance of end-Dec 2007 PCs
38.1700	1/	

1/ Equivalent to 55 percent of Malawi's quota (SDR 69.4 million).

Table 6b: Malawi: Indicators of Fund Credit, 2005-18
(In millions of SDRs, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fund credit outstanding 1/														
In millions of SDRs	52.6	51.3	49.3	48.7	44.6	42.0	39.2	32.8	24.4	16.8	9.1	3.1	0.5	0.0
In millions of U.S. dollars	80.4	78.5	75.6	74.6	68.3	64.4	60.0	50.3	37.3	25.7	14.0	4.7	0.7	0.0
In percent of quota	75.8	73.9	71.1	70.2	64.3	60.6	56.4	47.3	35.1	24.1	13.1	4.4	0.7	0.0
Existing stock														
In millions of SDRs	52.6	39.7	26.3	20.9	16.8	14.2	11.3	8.0	4.6	2.6	0.5	0.0	0.0	0.0
In millions of U.S. dollars	80.4	60.7	40.2	32.0	25.7	21.8	17.4	12.2	7.1	3.9	0.8	0.0	0.0	0.0
In percent of quota	75.8	57.1	37.8	30.1	24.2	20.5	16.3	11.5	6.7	3.7	0.7	0.0	0.0	0.0
Proposed disbursement														
In millions of SDRs	5.4	16.5	11.5	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In millions of U.S. dollars	8.3	25.3	17.5	7.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In percent of quota	7.8	23.8	16.5	6.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund obligations														
Fund total charges and interest 2/	13.2	18.5	14.2	6.0	4.7	3.2	3.5	6.9	9.0	8.1	8.1	6.5	3.0	0.9
Existing drawings	0.816	1.0	0.8	0.7	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.4
Prospective drawings	0.8	1.0	0.8	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Fund total repayment/repurchase 3/	12.4	17.5	13.4	5.4	4.1	2.6	2.9	6.4	8.5	7.6	7.6	6.1	2.6	0.5
Existing drawings	12.4	17.5	13.4	5.4	4.1	2.6	2.9	3.4	3.4	2.1	2.1	0.5	0.0	0.0
Prospective drawings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.0	5.1	5.6	5.6	5.6	2.6	0.5
Net Fund credit	-6.9	-1.0	-2.0	-0.6	-4.1	-2.6	-2.9	-6.4	-8.5	-7.6	-7.6	-6.1	-2.6	-0.5
Net use of Fund resources, excluding HIPC assistance	-7.8	-2.0	-2.8	-1.2	-4.7	-3.2	-3.5	-6.9	-9.0	-8.1	-8.1	-6.5	-3.0	-0.9
Fund HIPC assistance	1.4	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net use of Fund resources, after HIPC assistance	-6.4	-1.0	-2.8	-1.2	-4.7	-3.2	-3.5	-6.9	-9.0	-8.1	-8.1	-6.5	-3.0	-0.9
Fund credit outstanding in percent of														
Exports of good and nonfactor services	14.2	12.8	11.9	11.4	10.1	8.7	7.5	5.8	4.0	2.6	1.3	0.4	0.1	0.0
Gross official reserves	61.3	67.2	36.1	24.7	18.7	14.4	11.7	9.3	6.5	4.2	2.2	0.7	0.1	0.0
Fund obligations in percent of														
Exports of good and nonfactor services	3.6	4.6	3.4	1.4	1.1	0.7	0.7	1.2	1.5	1.2	1.1	0.9	0.4	0.1
Gross official reserves	12.7	24.0	10.4	3.0	2.0	1.1	1.0	2.0	2.4	2.0	1.9	1.4	0.6	0.2
Memorandum items:														
Quota (in millions of SDR)	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4
Export of goods and nonfactor services (in millions of U.S. dollars)	566	614	636	657	678	738	799	862	929	1,001	1,079	1,163	1,254	1,352
Gross official reserves (millions of U.S. dollars)	159	118	211	303	366	447	512	542	575	609	646	685	726	769

Sources: Malawi authorities; and Fund staff estimates and projections

1/ Includes the prospective disbursement under the Poverty Reduction and Growth Facility arrangement for a total of SDR 38.2m (55 percent of quota) and the repurchase of the outstanding General Resources Account drawings under the emergency post-conflict assistance.

2/ Before the subsidization of charges.

3/ Excludes HIPC assistance

APPENDIX I—LETTER OF INTENT

August 7, 2006

Mr. Rodrigo de Rato y Figaredo
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. de Rato:

1. The first review of the economic program supported by Malawi's arrangement with the Fund under the Poverty Reduction and Growth Facility (PRGF) was completed on February 6, 2006. In the attached Supplement to the Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding, we review progress in implementing the program in the fiscal year 2005/06 and update the macroeconomic framework and policy measures for 2006/07. The Government of Malawi believes that implementation of the PRGF-supported program through end-December 2005 was satisfactory: we met all the quantitative performance criteria for end-December 2005 by a comfortable margin.
2. The government of Malawi requests the completion of the second review and the third disbursement under the PRGF arrangement in the amount of SDR4.9245 million. In this connection, the Government also requests the IMF Executive Board to grant waivers for the nonobservance of the structural performance criteria relating to the budget ceilings module in the payment system and the new travel policy. The government expects that the new travel policy will be implemented by end-September 2006, and agrees that this should be a structural benchmark for the third review scheduled for mid-December 2006. The fifth disbursement will be subject to the fourth review expected to be completed in May 2007.
3. The Government of Malawi is committed to continued strong performance under the economic program supported by the PRGF arrangement. The Government has also been diligently implementing its poverty reduction strategy, and has made good progress in meeting most of the triggers for reaching the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. The Government of Malawi therefore believes that Malawi should reach the HIPC Initiative completion point at the time of the second review of the PRGF. Reaching the HIPC Initiative completion point would also immediately qualify Malawi for further debt relief under the Multilateral Debt Relief Initiative. The debt relief provided under these two initiatives will assist Malawi in achieving its growth and poverty reduction objectives.
4. The Government of Malawi believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but will take any further measures that

may become appropriate for this purpose. We will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the supplementary MEFP, in accordance with the IMF's policies on such consultation.

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

Sincerely yours,

/s/
Goodall Gondwe
Minister of Finance

/s/
Victor Mbewe
Governor
Reserve Bank of Malawi

Attachments

APPENDIX I—ATTACHMENT I

Supplement to the Memorandum of Economic and Financial Policies of the Government of Malawi

August 7, 2006

1. **The current memorandum supplements the policies presented in our Memorandum of Economic and Financial Policies (MEFP) of July 2005 (Country Report No. 05/285) and February 2006 (Country Report No. 06/94).** This memorandum covers remaining policies for FY2005/06, the FY2006/07 budget, key structural measures, and progress in implementing the HIPC completion point triggers.

I. FY 2005/06 UPDATE

2. **We welcome the IMF's recognition of Malawi's satisfactory performance under the PRGF arrangement at the Executive Board discussion on the first review in February 2006.** We particularly welcomed the views of some Executive Directors that our performance warranted commendation and that Malawi deserves to reach the HIPC completion point by mid-2006. Regarding the current review, we met all the quantitative performance criteria targets for end-December, 2005, as well as the indicative targets on reserve money (Table 1). However, we missed the indicative target on discretionary government spending, mainly because of food security outlays. As to the structural performance criteria, a new travel policy was developed by a consultant, but was not implemented as it did not adequately address our objectives (Table 2). We now aim to implement this measure by end-September 2006 (structural benchmark). Efforts to fully implement the budget ceilings module were overtaken by the rollout of the Integrated Financial Management Information System (IFMIS) and the centralized payment system.

3. **The food crisis continued to affect policy implementation.** The crisis was much deeper than was forecast at the time the budget was prepared. Maize and fertilizer operations in the second quarter were delayed by severe logistical difficulties and costs rose significantly. Since the last update, we increased our food operations to meet higher needs during the lean period before the new crop was harvested starting in March 2006 (Box 1). As a result, budget expenditures in FY05/06 are projected to have increased by MK 4.5 billion, which will be offset by MK 3.6 billion in higher donor support and commercial maize sales receipts.

4. **Yet prospects for 2006 are good.** Crop estimates point to a significant rebound in agricultural output resulting in GDP growth around 8½ percent. Despite delays in the auctions for the tobacco crop, the onset of tobacco and tea exports, together with the exchange rate depreciation by end-May 2006 of over 12 percent since mid-January 2006, will enable us to eliminate the import backlog that accumulated in 2005. A good harvest

combined with tight monetary policies will contribute to reducing inflation to 7.9 percent by December 2006.

A. Monetary and Exchange Rate Policies

5. **The objective of monetary policy continues to be price stability** anchored by a reserve money target. This framework requires the continued flexibility of interest and foreign exchange rates, which is necessary to meet the foreign reserve and reserve money targets.
6. **We reduced the liquidity reserve requirement (LRR) in February 2006.** This resulted in an increase in excess reserves in the banking system. In order to prevent this action from threatening our inflation objectives, we have taken steps to mop up the excess reserves. The LRR reduction aims to lower the intermediation costs of commercial banks. Following the rate reduction, deposit rates offered at most commercial banks increased, lowering the interest rate spread between lending and borrowing rates. Moreover, the reduced LRR will contribute to the program objective of shifting the implementation of monetary policy from a reliance on direct instruments, such as the LRR, towards the use of indirect instruments, such as sales of treasury and RBM bills.
7. **We are committed to a flexible exchange rate regime,** as required by our monetary framework and limited reserves. At the same time, we recognize the need to avoid excessive volatility in a shallow market and the need to smoothen seasonal fluctuations. Moving forward, we are committed to a more transparent and flexible exchange rate regime—as demonstrated by the more than 12 percent depreciation in the exchange rate from mid-January to end-May 2006—in which the exchange rate fully reflects underlying demand and supply conditions.
8. **Reducing the import backlog is of utmost importance.** The reduction of the backlog was complicated by the food crisis that turned out to be worse than previously projected. We are now systematically monitoring the backlog on a weekly basis and agreed with commercial banks to record the exchange control numbers of all import orders to help eliminate double counting in our backlog estimate. We reduced the backlog from approximately US\$78 million in early 2006 to US\$54 million at end-March 2006 (a structural benchmark). Further reductions were hampered by low export receipts on account of delays in the tobacco auctions. The backlog was nevertheless reduced to US\$12.7 million by end-June 2006 and was subsequently eliminated in late July 2006.
9. **Our foreign exchange position is expected to remain on track.** This is largely due to an increase in projected exports, which will offset the additional maize imports earlier in the year. Through end-2006, additional IMF debt relief under the Multilateral Debt Relief Initiative (MDRI) will allow us to build reserves to about two months import coverage.

B. Fiscal Policies

10. **Fiscal performance through the second quarter was better than programmed.** This was mainly because of a refund of debt service from the AfDB (interim HIPC assistance due in 2004), delays in food security outlays and the postponement of planned wage increases, which offset an increase in other recurrent spending. Fiscal performance in the third quarter was negatively affected by the large increase in food security transactions (see above and Box 1). There were also further increases in other recurrent expenditures that were partly curtailed during the fourth quarter.

11. **In February 2006, we implemented the FY2005/06 wage increase retroactive from December 2005.** Delays in implementation stemmed from difficulties in contracting an appropriate consultant. Prior to the exercise, a database of all government employees was compiled (a performance criterion), and a wage schedule was completed (a structural benchmark). Still, some government employees were erroneously overcompensated and errors in the calculation of the payroll led to a projected overrun of approximately MK 700 million for the fiscal year in the absence of corrective measures. The overpayment was clawed back in the fourth quarter. In addition, we have identified and corrected other sources of unauthorized compensation in the payroll. These actions together eliminated the wage overrun.

12. **For the whole fiscal year, however, we will not be fully able to achieve the target for domestic borrowing.** This is largely explained by the increase in food security transactions noted above. In addition, expenditures were increased to pay university salaries, higher Parliamentary sitting costs, and larger-than-anticipated costs of terminating housing contracts following changes to the pay policy. Buoyant tax revenues and the AfDB debt relief refund will offset part of the additional expenditures.

II. THE FY2006/07 BUDGET

13. **The FY2006/07 budget will aim to repay domestic debt.** Tax cuts in the individual income tax will be accompanied by expenditure restraint to achieve an improvement in the underlying balance (a measure of domestic adjustment effort) to over 1 percent of GDP and to support a further reduction of domestic debt to about 16 percent of GDP. Passage of a budget in line with the program is a prior action for the second review.

14. **Expenditures will be contained in the following key areas:**

- **Wages:** We will seek to limit wage increases to compensate for overruns in the previous two fiscal years. This will help bring our wage bill as a percent of GDP, to a lower level as that programmed for FY2005/06.

- **Pensions:** Under the current formula, pension costs are expected to increase significantly in FY06/07 because of the October 2004 wage reform. We will adjust the pension formula, mainly by adopting a lower accrual rate to limit the increase in the pension bill for FY06/07 (a prior action), with a view to ensuring the long-term viability of the existing pension system.
- **Recurrent Expenditures:** We have developed and implemented new policies on housing, the use of government vehicles, and administrative measures to prevent new utility arrears.

15. **Other important expenditure policies that will be part of the budget include maize, fertilizer, arrears repayment, and the construction of the parliament building.** We will intensify our dialogue with the World Bank and other bilateral donors on ways to improve the effectiveness of food policies, while paying close attention to containing the costs to the budget.

- **Maize:** Maize operations will remain an integral component of the budget. As we are expecting a bumper crop this year, our operations will be limited to replenishing 60,000 tons in the Strategic Grain Reserve, with donor support as well as our own resources, and continuing sales of maize through ADMARC depots (40,000 tons). Maize will be sold at market prices to ensure full cost recovery.
- **Fertilizer:** We will aim to import 150,000 tons of fertilizer for sale at a subsidized price. The total cost of the subsidy is projected at MK 7.3 billion.
- **Arrears Repayment:** In 2005, Cabinet approved a policy paper to address the large stock of domestic arrears and the policy is now being implemented. With the success of this strategy, we have increased the budget allocation to MK2 billion for domestic arrears reduction.
- **Parliament Building:** The budget will include MK 0.7 billion for preliminary construction costs. Early estimates suggest that the total cost of the parliament building could be MK 6 billion spread over several budget cycles. We will ensure costs are manageable, including through efforts to identify donor support. We will make sure all expenses are properly budgeted.

16. **We are in the process of restructuring the Malawi Development Corporation (MDC) reflecting its poor performance.** This has become more pressing following MDC's failure to service its debts. The privatization commission will prioritize and liquidate assets sufficient to cover the outstanding debt.

III. STRUCTURAL REFORMS

17. **We have started to flesh out several areas of the structural reform agenda for FY2006/07 and beyond**, as outlined in our Malawi Growth and Development Strategy (MGDS). In particular, we would highlight areas in public financial management (PFM), central bank independence, and the financial sector.

Public Financial Management

18. **In the context of both the Multilateral Debt Relief Initiative (MDRI) and possible future scaling-up of donor flows, improving PFM systems is imperative.** In 2004, Malawi met about one-third of the benchmarks in the Assessment and Action Plan for HIPC. Areas highlighted for improvement included budget comprehensiveness, internal control and reconciliation in budget execution, and audited financial reports. In collaboration with donors, we are developing an action plan that prioritizes reforms, describes existing donor support, and identifies remaining areas of need for technical assistance and expect to have this completed by end-October 2006 (structural benchmark).

19. **We have embarked on our reforms by phasing in a new Integrated Financial Management Information System and centralized payment system.** This system will improve expenditure control and tracking. In the coming months, we will closely monitor the implementation of IFMIS with support from both IMF technical assistance, including to help set up a Government Finance Statistics module, and the U.S. Millennium Challenge Threshold program.

20. **The new system, on the other hand, makes certain structural agenda items less important.** We will not devote further resources toward implementing the budget ceiling module (a performance criteria) or measures to strengthen management and expenditure monitoring procedures (structural benchmark) as payments will now largely pass through the centralized payment system (IFMIS). Though with some delay, we have published reports on the budget and expenditure arrears (structural benchmarks).

Financial Sector and Central Bank Independence

21. **We are committed to improving banking supervision operations as a step toward enhancing financial intermediation.** As an initial step, we have recently completed an impact analysis of commercial bank balance sheets (a structural benchmark) using asset classifications consistent with international best practice (a structural benchmark). Based on these results, we have subsequently implemented the new directives governing classification and provisions. We have also begun liquidation procedures for Finance Bank and expect the process to be completed within six months. This bank was initially closed and placed under RBM management in mid-2005, but due to the lack of a suitable buyer, we have now decided to liquidate the bank. We anticipate receiving an FSAP in early 2007.

22. **We have begun to implement the recommendations in the safeguards assessment.** We reconstituted the Board of Directors of the RBM in March 2006, re-established an audit committee, and formally adopted a rotation policy for external auditors. We have also expanded the disclosures in the financial statement, including disclosures on the amount of foreign reserves that are under the control of the Treasury.

23. **The final recommendation of the safeguard assessment, central bank independence, will be guided by the regional SADC initiative in this area.** A SADC model law is expected to be finished shortly and we will aim to adopt a version for Malawi as soon as is feasible. The law should ensure that the Board of Directors, including the Governor and the Deputy Governor, can be removed only for legal cause and after due process.

IV. HIPC COMPLETION POINT

24. **We are determined to reach the HIPC Initiative completion point by mid-2006.** In preparation, we have made progress on HIPC completion point triggers, our poverty reduction strategy, and on debt reconciliation.

- **HIPC triggers:** We have implemented most triggers, but anticipate the need to request two waivers—one for student enrolment in teacher training institutions and one for the percentage of recurrent expenditures spent on health. Performance on the latter, however, has significantly improved since the implementation of the Health SWAp.
- **Poverty-reduction strategy:** As the Malawi Poverty Reduction Strategy expired in mid-2005, our efforts to reduce poverty and enhance development will henceforth be guided by a new strategy outlined in the MGDS, which was submitted to Cabinet in May 2006. In addition, we have finalized the third Annual Progress Report covering July 2004 to end-2005.
- **External debt:** We have now reconciled and confirmed with creditors debt data used at the HIPC decision point for end-1999, and debt data for end-2005.

25. **At the HIPC Initiative completion point, we will qualify for debt relief under the MDRI.** Debt relief from the IMF will be transferred to the government on a flow basis as the debt service falls due. The budget will incorporate debt relief under the MDRI from the World Bank and also from the AfDB later in the fiscal year. Any increase in resource inflows will be incorporated in a supplementary budget. Resources are expected to be used to help Malawi meet the Millennium Development Goals. In cooperation with donors, civil society, and other important stakeholders, we have revised our definition of pro-poor expenditures as well to help better target the use of resources.

V. PROGRAM MONITORING

26. The PRGF-supported program will continue to be monitored quarterly, based on the quantitative and structural measures indicated in tables 1 and 2. These targets are defined in the attached Technical Memorandum of Understanding (TMU).

Box 1: Food Security in FY05/06

Our food security efforts through the food crisis were hampered by severe logistical difficulties and higher purchase and transportation costs. In early 2006, we increased our food security operations to meet the higher estimates of food needs during the lean period before the new crop (that has turned out to be larger than normal) could be harvested starting in late March. To help meet these needs, we imported additional maize for sale at subsidized prices through Admarc and added the distribution of food supplements at no cost to the most vulnerable. As a result, budget expenditures are estimated to have increased by MK 4.5 billion (to about MK 17.5 billion), the larger part of which was financed by donors (mostly the UK) and higher sales receipts. The net cost to the budget is estimated to have increased by MK 0.9 billion from MK 3.6 billion to MK 4.5 billion.

Humanitarian Our relief efforts through the Strategic Grain Reserve (SGR) did not change significantly since late 2005 and the higher purchase and transportation costs were fully met by donors. Taking into account stocks carried over from FY04/05, we distributed about 167,000 tons of maize, of which we purchased 40,000 tons using our own resources. The relief effort was also complemented by the purchase and distribution of food supplements that was fully funded by donors.

Commercial: Taking into account stocks carried over from FY04/05, the budget also allowed for the purchase and sale of 50,000 tons at subsidized prices by Admarc using our own resources. Under pressure from the food crisis, this amount was raised to 68,000 tons by November and was increased further to 93,000 tons. This has increased the subsidy cost to the budget by MK 0.7 billion to MK 1.2 billion.

Fertilizer: The depletion of farmers' resources by the drought made it imperative to provide affordable fertilizer and maize seeds to ensure an adequate crop in FY06/07. The budget allowed for 137,000 tons of fertilizer to be imported and sold at subsidized prices; an amount that was later increased by 10,000 tons. The scheme also allowed for the sale of 6000 tons of seeds. These amounts were unchanged, but higher costs increased the estimated subsidy costs for fertilizer and seeds by MK 1.5 billion to MK 6.9 billion.

Malawi: Government Maize Transactions in FY2005/06

Thousand of metric tons

	Country Report	Country Report	Current
	05/285	06/94	
	August 2005	February 2006	
Carry over	51	51	51
SGR	31	31	31
Commercial	20	20	20
Purchases for FY05/06	149	190	209
SGR	119	142	136
Replenishment FY05/06	29	31	
Other SGR purchases	90	111	105
of which GoM	12	40	40
Commercial	30	48	73
Total distribution	200	241	260
SGR	150	173	167
Commercial	50	68	93

Sources: Government of Malawi, donors and IMF staff.

Table 1. Malawi: Quantitative Targets, June 2005-March 2006 1/
(Cumulative flows from June 30, 2005)

Criteria	Jun. 2005 Stock Actual	End-Sep. 2005			End-Dec. 2005. Test Date			End-Mar. 2006		
		Ctry. Rept. 05/285	Adjusted Target	Actual	Ctry. Rept. 05/285	Adjusted Target	Actual	Ctry. Rept. 06/94	Adjusted Target	Actual Est.
I. Monetary Targets (Millions of Malawi kwacha)										
1. Ceiling on net domestic assets of the monetary authorities 2/	PC 3/	15,520	-3,133	-4,466	-1,839	2,070	231	-1,564	-2,842	-1,197
2. Ceiling on reserve money	IT	19,580	1,314	534.1	1,324	...	1,324	-1,690	...	-2,080
II. Fiscal Targets (Millions of Malawi kwacha)										
3. Ceiling on central government's net domestic borrowing 2/ 4/ 5/	PC 3/	53,923	-783	-1,644	-599	1,578	979	180	474	653
4. Ceiling on central government wages and salaries 4/	PC 3/	...	4,848	4,802.3	9,934	-21	9,913	14,914	174	15,356
5. Ceiling on central government discretionary expenditures 4/	IT	...	15,123	12,311.3	29,424	-844	28,580	40,873	-387	40,486
III. External Targets (Millions of U.S. dollars)										
6. Floor on net foreign assets of the monetary authorities 2/	PC 3/	33.0	36.1	40.7	25.7	-16.8	8.9	-1.0	-10.0	-7.2
7. Ceiling on the accumulation of external payments arrears 6/	PC 3/	...	0.0	0.0	0.0	...	0.0	0.0	...	0.0
8. Ceiling on new nonconcessional external debt with a maturity of one year or more 6/	PC 3/	...	0.0	0.0	0.0	...	0.0	0.0	...	0.0
9. Ceiling on new nonconcessional external debt with a maturity of less than one year 6/	PC 3/	...	0.0	0.0	0.0	...	0.0	0.0	...	0.0
Memorandum items (Millions of Malawi kwacha):										
Balance of payments support (In millions of U.S. dollars)		60.2	0.0	35.7	105.2	-16.8	...	116.4	-10.0	91.4
Health SWAp wage expenditures		177	-38	138.2	358	-21	...	322	174	496
Health SWAp ORT expenditures		1,016	401	1,417.4	2,062	-844	...	2,399	-387	2,011
Net Movement in special accounts		-269	-188	-81	678	-502	...	1,049	-783	1,832
Net movement in NAC account		0	313	-312.8	0	91	...	-368	-35	-333
Maize revenue		170	-130	299.57	504	-249	...	1,157	106	1,051
Net movement in Health SWAp account		-439	-371	-67.6	174	-343	...	259	-853	1,113
Swap receipts		754	...	1,495.6	2,594	...	...	2,980	...	3,656
Swap payments		-1,193	...	-1,563.2	-2,420	...	...	-2,721	...	-2,543
Cash payment of arrears		500	...	636.70	1,000	0	...	1,604	...	1,969
Liquidity Reserve Requirement		27.5	0	27.5	27.5	0	...	27.5	...	20.0
Program exchange rate		123	123	123	123	123	123	123	123	123

PC - performance criteria; IT - indicative target

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

2/ Targets are subject to an adjuster for BOP support.

3/ Targets for end-March are indicative.

4/ Targets are subject to an adjuster for donor-funded health expenditures.

5/ Targets are subject to adjusters for maize revenue and cash payment of arrears.

6/ Evaluated on a continuous basis.

Table 1. Malawi: Quantitative Targets, June 2006-December 2006 1/ (concluded)
(Cumulative flows from June 30, 2005)

Criteria	Jun. 2005 Stock Actual	End-Jun. 2006: Test Date		End-Sep. 2006		End-Dec. 2006: Test Date	
		Country Report 06/94	Proj.	Target	Target	Target	Target
(Cumulative flows from June 30, 2005)							
I. Monetary Targets (Millions of Malawi kwacha)							
1. Ceiling on net domestic assets of the monetary authorities 2/	15,520	-375	-2,577	-7,201	-2,640		
2. Ceiling on reserve money	19,580	3,170	613	1,582	2,486		
II. Fiscal Targets (Millions of Malawi kwacha)							
3. Ceiling on central government's net domestic borrowing 2/ 4/ 5/	53,923	-1,661	1,081	3,206	6,010		
4. Ceiling on central government wages and salaries 4/	...	20,448	20,448	26,158	31,956		
5. Ceiling on central government discretionary expenditures 4/	...	53,054	59,209	73,897	90,413		
III. External Targets (Millions of U.S. dollars)							
6. Floor on net foreign assets of the monetary authorities 2/	33.0	28.8	25.9	71.4	41.7		
7. Ceiling on the accumulation of external payments arrears 6/	...	0.0	0.0	0.0	0.0		
8. Ceiling on new nonconcessional external debt with a maturity of one year or more	...	0.0	0.0	0.0	0.0		
9. Ceiling on new nonconcessional external debt with a maturity of less than one year	...	0.0	0.0	0.0	0.0		
Memorandum items (Millions of Malawi kwacha):							
Balance of payments support (in millions of U.S. dollars)		144.5	137.8	159.0	167.4		
Debt service payments to the WB and the ADB				7.0	0.4		
IMF debt relief transfers from the RBM to the CG				4.5	8.7		
Health SWAp wage expenditures		730	730	977	1,230		
Health SWAp ORT expenditures		3,873	4,660	4,413	7,050		
Net Movement in special accounts		1,693	1,387	3,590	1,915		
Net movement in NAC account		0	0	0	0		
Maize revenue		1,157	1,051	1,091	1,411		
Net movement in Health SWAp account		536	335	2,498	503		
Swap receipts		5,139	5,792	7,955	8,883		
Swap payments		-4,603	-5,457	-5,457	-8,379		
Cash payment of arrears		2,000	2,000	2,500	3,000		
Liquidity Reserve Requirement		27.5	20.0	20.0	20.0		
Program exchange rate	123	123	123	123	123		

PC - performance criteria; IT - indicative target

- 1/ Targets are defined in the technical memorandum of understanding (TMU).
- 2/ Targets are subject to an adjuster for BOP support.
- 3/ Targets for end-September are indicative.
- 4/ Targets are subject to an adjuster for donor-funded health expenditures.
- 5/ Targets are subject to adjusters for maize revenue and cash payment of arrears.
- 6/ Evaluated on a continuous basis.

Table 2. Malawi: Proposed Prior Actions, Structural Performance Criteria and Benchmarks
December 2005–December 2006

Number	Description	Date	Status
Prior Actions for completion of the Second Review under the PRGF arrangement			
1	Parliament approval of 2006/07 budget in line with macroeconomic framework specified in the TMU (para. 34)	August 2006	Implemented
2	Implement adjustment formula to the current pension system. (TMU para 35)		
Performance Criteria			
1	Make budget ceilings module in payment system fully operational (TMU, para. 36)	End-Dec. 2005	Not implemented
2	Develop and implement new travel policy, which includes mechanisms for monitoring adherence (TMU, para. 37).	End-Mar. 2006	Not implemented
Structural Benchmarks			
1	Develop detailed schedule of wage adjustments by grade for 2005/06	End-Sep. 2005	Implemented in February 2006
2	Publish monthly fiscal reports with one month lag (TMU, para. 38)	End-Dec. 2005	Implemented with a delay
3	Prepare quarterly reports (with one month lag) on status of arrears.(TMU para. 38)	End-Dec. 2005	Implemented with a delay
4	Strengthen cash management and expenditure monitoring procedures by preparing reports as indicated in the TMU (para. 40)	End-Mar. 2006	Not implemented
5	Complete impact analysis of tighter credit quality classifications on commercial bank balance sheets (TMU, para. 39)	End-Mar. 2006	Implemented
6	Reduce import backlog of commercial bank foreign exchange applications for import-related payments, as defined in the TMU (para. 46)	End-Mar. 2006	Implemented
7	Eliminate import backlog of commercial bank foreign exchange applications for import-related payments (TMU para. 46)	End-Jun. 2006	Implemented
8	Develop and implement new travel policy, which includes mechanisms for monitoring adherence (TMU, para. 37)	End-Sept 2006	
9	Formulate an action plan to address weaknesses in the area of PFM (TMU para. 45)	End-Oct. 2006	

APPENDIX I—ATTACHMENT II
Malawi: Technical Memorandum of Understanding

1. This memorandum sets out the definitions for the quantitative and structural targets under which Malawi's performance under the Poverty Reduction and Growth Facility arrangement will be assessed. Monitoring procedures and reporting requirements are also specified.
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 the 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 three-bank monetary survey.

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Floor on Net Foreign Assets of the Monetary Authorities

3. **Definition of net foreign assets (NFA) of the monetary authorities:** NFA of the monetary authorities are defined as the difference between gross foreign assets and liabilities. NFA will be valued in U.S. dollars, and monetary gold will be valued at the fixed RBM accounting rate. The counterpart entry to the central government's international reserve assets will be classified as a negative entry under "net credit to central government".
4. **Gross foreign assets** of the monetary authorities, or reserve assets are defined in the *International Reserve and Foreign Currency Liquidity Guidelines for a Data Template (Guidelines)*. 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) holdings of convertible, liquid, and unpledged claims on non-residents, such as deposits abroad, and foreign securities. Excluded are any foreign currency claims on residents, capital subscriptions in international institutions, assets in nonconvertible currencies, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities. It also excludes transfers of foreign currency claims to the monetary authorities by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates (*Guidelines*, Chapter 2).
5. **Gross foreign 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 non-residents with an original maturity of up to, and including, one year.

6. **Adjustment clause on net foreign assets—balance of payments support:** The floor on NFA of the monetary authorities will be adjusted upward (downward) by the full amount by which the cumulative receipts from the balance of payments support are greater (less) than the program baseline (see Table 1). The downward adjustment will be capped at US\$10 million.

7. **Definition of balance of payments support:** Balance of payments support includes all grants and foreign financing that is not 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 usage of the Tokyo-Mitsubishi account, and loan financing from the IMF. Balance of payments support is measured as the cumulative flow from June 30, 2005.

8. **Adjustment clause on net foreign assets—debt service payments:** The floor on NFA 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 falls short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from June 30, 2006.

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

9. **Definition of net domestic assets (NDA) of the RBM:** NDA of the RBM is defined as reserve money minus net foreign assets valued at the program exchange rate (end-March 2006) of MK123 per US\$1. 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.

10. **Adjustment clause on net domestic assets—balance of payments support:** The ceiling on NDA of the RBM will be adjusted downward (upward) by the full amount by which the cumulative flow of receipts from balance of payments support is greater (less) than the program baseline. The upward adjustment will be capped at US\$10 million. Balance of payments support will be converted to Malawi kwacha using the program exchange rate (see para. 7 for the definition of balance of payments support).

11. **Adjustment clause on net domestic assets—liquidity reserve requirement:** The ceiling on NDA of the RBM will be adjusted downward for a decrease in the reserve requirement ratio, and the ceiling will be adjusted upward for an increase in the ratio. The adjuster will be calculated as follows: (one minus the 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 reservable deposit liabilities in commercial banks as at the end of the quarter prior to the change in regulation).

12. **Adjustment clause on net domestic assets—debt service payments:** The ceiling on NDA of the RBM will be adjusted downwards (upwards) 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 June 30, 2006.

C. Ceiling on Central Government's Domestic Borrowing

13. **Definition of central government's 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, and holdings of treasury bills minus deposits), (ii) net borrowing from commercial banks (including advances, holdings of local registered stocks and holdings of treasury bills minus deposits), (iii) net borrowing from nonbanks (including holding of local registered stocks, holdings of treasury bills, and supplier credits minus government deposits held at the Malawi Savings Bank), and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost rather than face value. Excluded are promissory notes issued to cover RBM's operational losses in 2002 and 2003. The ceiling is measured as the cumulative flow from June 30, 2005.

14. **Definition of June 2004 domestic arrears:** June 2005 domestic arrears consist of all domestic arrears for which the obligation to pay was established on or before June 30, 2004.

15. **Definition of domestic arrears:** Domestic arrears are overdue payment obligations by central government other than external payment arrears (see section I.E.), including on wages and salaries, pensions, transfers, domestic interest, goods and services, obligations arising from court cases, legally established compensation claims, and payments to the Malawi Revenue Authority (MRA) for 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 30 days of the date of invoice, or—if a grace period has been agreed—within the contractually agreed grace period.

16. **Adjustment clause on CGDB—balance of payments support:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the cumulative receipts from balance of payments support is greater (less) than the program baseline (see para. 7 for the definition of balance of payments support). The upward adjustment will be capped at US\$10 million.

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

18. **Adjustment clause on CGDB—cash payment of arrears:** The ceiling on CGDB will be adjusted downward by the full amount by which payments 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.
19. **Adjustment clause on CGDB—maize revenue:** The ceiling on CGDB will be adjusted upward (downward) by the full amount by which the cumulative receipts from the sale of commercial maize through ADMARC and deposited in the RBM maize account is less (greater) than the program baseline (see Table 2).
20. **Adjustment clause on CGDB—donor pool account for the health SWAp:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the change (in kwacha) of the stock in the U.S. dollar denominated donor pool account for the health SWAp at the RBM is larger (smaller) than the change (in kwacha) of the stock in that account in the program baseline (Table 2). The change in stock is measured relative to the stock as of June 30, 2005. Stocks in the account are stated with a positive sign.
21. **Adjustment clause on CGDB—National Aids Commission (NAC) accounts:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the change (in kwacha) of the stock in the accounts of the NAC held in the Malawi banking system is larger (smaller) than the change (in kwacha) of the stock in those accounts in the program baseline (Table 2). The stock of the NAC accounts will be determined on the basis of the quarterly financial reports of the NAC. The change in stock is measured relative to the stock as of June 30, 2005. Stocks in the accounts are stated with a positive sign.
22. **Adjustment clause on CGDB—transfer of IMF debt relief from the RBM:** The ceiling on net CGDB will be adjusted downwards (upwards) by the full amount by which the full cumulative amount of debt relief provided by the IMF under the HIPC Initiative and the MDRI at the HIPC completion point and transferred by the RBM to the Government of Malawi exceeds (falls short of) the program baseline (Table 1). The cumulative amount will be measured from June 30, 2006.
23. **Adjustment clause on CGDB—debt service payments:** The ceiling on net CGDB will be adjusted downwards (upwards) 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 June 30, 2006.

D. Ceiling on Central Government Wages and Salaries

24. **Definition of central government wages and salaries:** Central government wages and salaries include all payments that are classified as personnel emoluments in government budgets and accounts, including payments on arrears of personnel emoluments and allowances. The ceiling is measured as a cumulative flow from June 30, 2005.

25. **Adjustment clause on central government wages and salaries—donor-funded wages and salaries in the health sector:** The ceiling on central government wages and salaries will be adjusted upward (downward) by the full amount of donor-funded supplementary wages and salaries for the health sector that is greater (less) than the program baseline (Table 2).

E. Ceiling on External Payments Arrears

26. **Definition of external payment arrears:** External payment arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the 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.

F. Ceiling on Nonconcessional External Debt

27. **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, a short- and medium- and long-term debt is nonconcessional if it includes a grant element 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 June 30, 2005.

28. Short-term debt: outstanding stock of debt with an original maturity of one year or less.

29. Medium- and long-term debt: outstanding stock of debt with a maturity of more than one year.

30. 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.

II. QUANTITATIVE INDICATIVE TARGETS

A. Ceiling on Reserve Money

31. **Definition of reserve money:** Reserve money is defined as the sum of currency issued by the RBM 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.

B. Ceiling on Central Government Discretionary Expenditures

32. **Definition of central government discretionary expenditures:** These are defined as all expenditures excluding (i) wages and salaries, (ii) interest payments, and (iii) foreign-financed development expenditures (development Part I expenditures) which are related to specific projects. Central government discretionary expenditures include statutory (i.e., nonvoted) expenditures for pensions and gratuities, and compensation and refunds; but exclude tax refunds (which are treated as a negative revenue). Central government discretionary expenditures also include other recurrent expenditures (ORT), domestically financed development expenditures (development Part II expenditures), and net lending (if any). Included in this definition are also recurrent expenditures and development Part II expenditures for which cash financing is or was made available by donors. Included in particular are all maize purchases for the Strategic Grain Reserve, purchases financed from the Japan debt relief account (see para. 44), and expenditures in the health sector financed from the donor pool account in the RBM for the health SWAp. The ceiling is measured as a cumulative flow from June 30, 2005.

33. **Adjustment clause on central government discretionary expenditures—donor-funded central government discretionary expenditures in the health sector.** The ceiling on central government discretionary expenditures will be adjusted upward (downward) by the full amount of donor-funded **central government discretionary** health sector expenditures that is greater (less) than the program baseline (Table 2). In respect of resources made available through the U.S. dollar-denominated donor pool account for the health SWAp at the RBM (donor pool account), donor-funded central government discretionary expenditures in the health sector will be deemed to have been made according to the

calculation: ‘outflows from the donor pool account to finance expenditures, expressed in Malawi kwacha’ less ‘donor financed supplementary wages in the health sector’.

III. STRUCTURAL PRIOR ACTIONS, PERFORMANCE CRITERIA AND BENCHMARKS

34. **Approval of FY2006/07 budget:** The FY2006/07 budget passed by parliament should be in line with the program.
35. **Formula adjustment to pension formula:** Adjustments to the formula used to calculate an individual’s benefit should allow for a total cost of pensions lower than MK 4.8 billion in 2006/07.
36. **Budget ceiling module:** For the purposes of expenditure management, the budget module of the payments system at the RBM should be made fully operational. This requires that the following three steps are completed: (1) All bank accounts are reconciled between the RBM and commercial banks; (2) All data are reconciled between the RBM holding accounts and the fiscal data according to the Ministry of Finance ledgers; and (3) the Accountant General’s office provides the RBM with a list of check numbers for outstanding checks issued against the 2004/05 budget. These checks should be entered into the payment system in order to identify the float from the 2004/05 budget into fiscal year 2005/06 for the CCA system. Finally, the RBM should produce tables by CCA category listing funded amounts against total reimbursement for the current fiscal year. In the future, the Accountant General should develop a concordance between budget votes, cost centers, and RBM holding accounts into which CCAs are credited, and produce tables by budget vote.
37. **Travel Policy:** The Ministry of Finance will develop and implement (by issuing a circular) a travel policy that will aim to ensure accountability and control for all expenditure on travel.
38. **Publication of Fiscal Reports:** The Ministry of Finance will publish the following documents on a monthly basis: the GFS fiscal table, the arrears clearance report, and the report on pro-poor expenditures.
39. **Impact Analysis:** Collect information on credits overdue 30 days or more but less than 180 days. Based on this information, an analysis should be completed of tightening credit quality classification to 90 days for substandard, 180 days for doubtful, and one year for loss.
40. **Strengthening cash management:** Prepare and implement the following two reports: (1) a budget execution report based on a new monthly table by ministry and expenditure type (PE, ORT, and development, including below the line accounts like advances and imprests) that shows (i) approved budget per vote/ministry, (ii) funding released to ministries per funding table, (iii) commitments made as reported by ministries on commitment control

system reports (iv) expenditures as reported by ministries on expenditure returns, and (v) payments made according to CCA system; and (2) an amended funding table that indicates the allocation of funding based on three sources: the MG1 account, automatic payment by standing instruction (e.g., regular foreign payments or withholding), and foreign financing sources.

41. **PFM action plan:** The Ministry of Finance will develop an action plan that prioritizes reforms, describes existing donor support, and identifies remaining areas of need for technical assistance in the area of public financial management.

IV. TREATMENT IN THE FISCAL ACCOUNTS AND BALANCE OF PAYMENTS OF CERTAIN CENTRAL GOVERNMENT (CG) ACCOUNTS HELD ABROAD

42. **The account held with the Bank of Tokyo-Mitsubishi in Japan:** The account was set up for the delivery and administration of Japanese debt relief. Disbursements of cash debt relief into the account are accounted as grants with corresponding amounts of foreign financing (increases in the deposit account). Withdrawals from the Bank of Tokyo-Mitsubishi account are accounted as central government expenditures with corresponding amounts of foreign financing (decreases in the deposit account). Expenditures financed from this account are included in spending agencies budgets under current expenditures, or as development Part II expenditures (development expenditures financed by the Government of Malawi). Flows are valued at the end-month exchange rate.

43. **The European Union grants for food security purposes and the food reserve account.** These grants are given to provide a cash reserve to the Government of Malawi for the purchase of food stuff (in particular maize) at times of food shortages. Access to foreign or domestic accounts that have been or are being established to administer these resources is determined by agreements between the European Union and the Government of Malawi. Deposits into the account held abroad are recorded as grants with corresponding amounts of foreign financing (increase in deposit accounts). Withdrawals from the account held abroad are recorded as increase in foreign financing. If and when the resources are transferred to Malawi, they are to be held in a bank account in the banking system until needed, and are counted as part of net credit to government. Withdrawals from the foreign or domestic accounts for payments to suppliers are recorded as an appropriate expenditure item (e.g., purchase of food stuffs), and a decrease in the respective deposit account. Should the food reserve account be operated like a revolving fund, all cash inflows are accounted as appropriately classified revenue, and an increase in the deposit account. The balance in the foreign and domestic food reserve accounts is reported separately in the monetary data.

V. REPORTING OF CERTAIN TRANSACTIONS IN THE FISCAL ACCOUNTS

44. **Operations of the National Aids Commission (NAC).** Financial operations of the NAC are included in the fiscal accounts according to the NAC's financial reports. Expenditures are typically classified as development Part I expenditures. Government ministries and departments that execute projects financed by NAC report these activities to NAC for inclusion in the NAC's financial reports.

45. **Donor pool funded expenditures in support of the Health SWAp.** The Government of Malawi has embarked on the implementation of 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. Donor funded expenditures for the Health SWAp from the pooled resources will be deemed to have been made in the amount of outflows from the donor pool account to finance expenditures (i.e., typically either to Malawi government No. 1 account in Malawi kwacha, or to pay directly for imports by the health sector). The attribution of donor financed expenditures to personnel emoluments, other recurrent transactions, and development Part II expenditures is made on the basis of cash flow projections and established donor commitments to finance specific expenditures (e.g., supplementary wages and salaries for professional health cadres). Typically, expenditures for other recurrent transactions are estimated as the residual of outflows less expenditures for wages and salaries less expenditures for development Part II.

VI. REPORTING REQUIREMENTS

46. Monitoring of the program requires that the information listed in the tables shown below be reported to the IMF within the timeframe indicated in the table. The new data requirement for a list of the backlog of import applications for foreign exchange will include data by bank, and amounts separated by the following three categories: imports not yet delivered, imports delivered but within the grace period, and imports delivered but outside of the grace period.

Table 1. Malawi: Program Balance of Payments Support and Debt Service Obligations, FY2005/06 and FY2006/07
(In millions of U.S. dollars)

		FY05/06								FY06/07				
		Q1		Q2		Q3		Q4		Total				
Ctry. Rept. 05/285	Act.	Ctry. Rept. 05/285	Act.	Ctry. Rept. 06/94	Act.	Ctry. Rept. 06/94	Act.	Ctry. Rept. 06/94	Rev.	Ctry. Rept. 05/285	Ctry. Rept. 06/94	Rev.	Prog.	Prog.
Balance of payments support														
Grants	60.2	35.7	20.0	52.7	3.0	3.0	3.0	28.1	21.9	116.3	119.5	91.4	21.2	0.0
EU	18.8	0.0	0.0	17.5	0.0	0.0	0.0	28.1	21.9	51.7	45.6	17.5	0.0	0.0
IDA	0.0	0.0	20.0	29.9	0.0	0.0	0.0	0.0	0.0	20.0	29.9	29.9	0.0	0.0
UK	38.2	35.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	38.2	35.7	35.7	17.5	0.0
Norway	3.2	0.0	0.0	5.3	3.0	3.0	0.0	0.0	0.0	6.4	8.3	8.3	3.7	0.0
Loans	0.0	0.0	25.0	0.0	25.0	0.0	0.0	0.0	24.5	25.0	25.0	24.5	0.0	8.4
IDA	0.0	0.0	25.0	0.0	25.0	0.0	0.0	0.0	24.5	25.0	25.0	24.5	0.0	0.0
ADB	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.4
Total	60.2	35.7	45.0	52.7	28.0	3.0	28.1	46.4	141.3	144.5	116.0	116.0	21.2	8.4
Cumulative total	60.2	35.7	105.2	88.4	116.4	91.4	144.5	137.8	141.3	144.5	116.0	116.0	159.0	167.4
Debt service payments														
IDA													5.1	0.2
AfDB													1.9	0.2
Total													7.0	0.4
Cumulative													7.0	7.4
Pass-through of debt relief from the RBM to the GoM														
IMF													4.5	8.7
Cumulative													4.5	13.2

Sources: IMF, UK, EU, Norway, AfDB, and WB.

Table 2. Malawi: Program Maize Revenue, Health SWAp, and NAC Funds, FY2005/06 and FY2006/07
(In millions of Malawi kwacha)

	FY05/06										FY06/07			
	Q1		Q2		Q3		Q4		Total		Q1	Q2		
	Ctry. Rept. 05/285	Act.	Ctry. Rept. 05/285	Act.	Ctry. Rept. 06/94	Act.	Ctry. Rept. 06/94	Act.	Ctry. Rept. 05/285	Ctry. Rept. 06/94	Rev.	Prog.	Rev.	Prog.
<u>Maize revenue</u>														
Quarterly receipts	170	300	334	454	391	298	0	0	1,344	1,157	1,051	40	1,051	320
Cumulative receipts	170	300	504	753	1,157	1,051	1,157	1,051	1,344	1,157	1,051	1,091	1,051	1,411
<u>Health SWAp</u>														
Revenues	754	1,496	1,840	585	883	1,576	2,159	2,136	5,466	5,139	5,792	2,163	5,792	928
Expenditures	1,193	1,563	1,227	0	1,164	980	1,882	2,913	4,930	4,603	5,457	0	5,457	2,923
Wage expenditures	177	138	181	199	184	159	408	234	730	730	730	247	730	253
ORT Expenditures	1,016	1,417	1,046	-199	980	793	1,474	2,649	4,200	3,873	4,660	-247	4,660	2,637
Change in account balance	-439	-68	613	585	-281	595	277	-778	536	536	335	2,163	335	-1,995
Cumulative receipts	754	1,496	2,594	2,081	2,980	3,656	5,139	5,792	5,466	5,139	5,792	7,955	5,792	8,883
Cumulative expenditures	1,193	1,563	2,420	1,563	2,721	2,543	4,603	5,457	4,930	4,603	5,457	5,457	5,457	8,379
Cumulative change in account bal	-439	-68	174	517	259	1,113	536	335	536	536	335	2,498	335	503
Inflows to RBM (US\$ millions)												10		21
Cumulative total												10		31
<u>National AIDS Commission (NAC)</u>														
Revenues	1,269	455	1,309	1,928	1,340	264	1,364	564	5,282	3,320	3,211	1,413	3,211	1,445
Expenditures	1,269	768	1,309	1,706	1,340	506	996	231	5,282	3,320	3,211	1,413	3,211	1,445
Change in account balance	0	-313	0	222	0	-241	368	333	0	0	0	0	0	0
Cumulative change in account bal	0	-313	0	-91	-368	-333	0	0	0	0	0	0	0	0
Inflows to RBM (US\$ millions)												10		10
Cumulative total												10		20

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

Table 3. Malawi: Reporting Requirements

Data description	Data Freq.	Reporting		Delivery		
		Agency	Freq.	lag	date	Mode
Gross international reserves, exchange rate, and foreign exchange purchases and sale	D	RBM	W	2	F	E
Reserve money, OMO transactions, and RBM conversion of treasury bills	D	RBM	W	2	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
Four-bank monetary survey	M	RBM	M	30	30	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
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
Monthly exchange rates	M	RBM	M	30	30	E
FCDA holdings	M	RBM	M	30	30	E
Cash flow of foreign exchange	M	RBM	M	30	30	E
Foreign exchange exposure limits by bank	M	RBM	M	30	30	E
Bank statements of both the Health SWAp and government maize account held at the I	M	RBM	M	30	30	E
Seven bank monetary survey and full banking survey	M	RBM	M	45	15	E
Financial soundness indicators by banks	Q	RBM	Q	45	T15	E
Insurance company survey	Q	RBM	Q	45	T16	E
Fiscal table (GFS) including revenue, expenditure, and financing.	M	MOF	M	30	30	E
Funding tables on wages, other recurrent expenditures, and development	M	MOF	M	30	30	E
CCA, supplementary CCA, and reimbursement report	M	MOF	M	30	30	E
Pro-poor spending	M	MOF	M	30	30	E
Tokyo-Mitsubishi account statements	M	MOF	M	30	30	E
Revenue data (from MRA)	M	MOF	M	30	30	E
PSI import data	M	MOF	M	30	30	E
Ministry reports on commitment and expenditures (CCS3 and CCS4 returns)	M	MOF	Q	30	T30	E
New external loans contracted or guaranteed by the central government 1/	Q	MOF	Q	30	T30	E
List of nonreschedulable external arrears by creditor 2/	Q	MOF	Q	30	T30	E
Budget execution report, including arrears and prospects for meeting budget targets based on the CCS3 and CCS4	M	MOF	Q	45	T15	E
Borrowing of the ten major parastatals 3/	Q	MOF	Q	45	T15	E
Quarterly financial statements of the ten major parastatals and MSB	Q	MOF	Q	45	T15	H
Report on PRGF performance	Q	MOF	Q	45	T15	E
Report on verified pre 30. June 2004 expenditure arrears	Q	AuG	Q	45	T15	E
Report on new post 30. June 2004 arrears verified by AuG	Q	AuG	Q	45	T15	E
Annual audited financial statements of the ten major parastatals and MSB	A	MOF	A	90	Mar. 30	H
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	Mar. 15 Sep. 15	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/ To be reported by DAMD, including a detailed explanation.

3/ 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, Central Regional Water Board, and Southern Region Water Board.

APPENDIX II—MALAWI: RELATIONS WITH THE FUND
(As of June 30, 2006)

I. **Membership Status:** Joined 07/19/1965; Article VIII (December 7, 1995)

II. General Resources Account:	<u>SDR million</u>	<u>Percent Quota</u>
Quota	69.40	100.0
Fund holdings of currency	77.96	112.33
Reserve position in Fund	2.29	3.30
III. SDR Department:	<u>SDR million</u>	<u>Percent Allocation</u>
Net cumulative allocation	10.98	100.0
Holdings	0.75	6.80
IV. Outstanding Purchases and Loans:	<u>SDR million</u>	<u>Percent Quota</u>
PRGF arrangements	37.37	58.35
Emergency Assistance	10.84	15.63

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR million)</u>	<u>Amount Drawn (SDR million)</u>
PRGF	8/5/2005	8/4/2008	38.17	10.34
PRGF	12/21/2000	12/20/2004	45.11	12.88
PRGF	10/18/1995	12/16/1999	50.96	50.96

VI. **Projected Obligations to Fund, Including Board-Approved HIPC Initiative Assistance** (millions of SDRs; based on existing use of resources and present SDR holdings):

	<u>Forthcoming</u>				
	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Principal	8.55	13.41	5.37	4.10	2.58
Charges/Interest	<u>0.54</u>	<u>0.74</u>	<u>0.50</u>	<u>0.48</u>	<u>0.46</u>
Total	<u>9.09</u>	<u>14.14</u>	<u>5.88</u>	<u>4.58</u>	<u>3.04</u>

VII. Implementation of HIPC Initiative:

	<u>Enhanced Framework</u>
A. Commitment of HIPC assistance	
Decision point date	12/21/00
Assistance committed (NPV terms) ¹	
Total assistance (US\$ million)	643.00
<i>Of which:</i> Fund assistance (SDR million)	23.14
Completion point date	Floating
B. Delivery of Fund assistance (SDR million)	
Amount disbursed	11.57
Interim assistance	11.57
Completion point ²	0.00
Additional disbursement of interest income	0.00
Total disbursements	11.57

VIII. Safeguards Assessments:

A safeguards update of the Reserve Bank of Malawi (RBM) completed in January 2006 under the PRGF arrangement approved on August 5, 2005, followed up on RBM assessments completed in 2001 and 2003. The 2006 assessment found that although the RBM had taken steps to strengthen its operations, new vulnerabilities had emerged in governance and financial reporting. Recommendations to mitigate the identified weaknesses included: (i) reconstitution of the RBM board of directors, which was dissolved in August 2005, and the subsequent reestablishment of an audit committee; (ii) expansion of explanatory notes in the financial statements to include advances to the government and a letter of credit financial commitments; and (iii) strengthening of the central bank law provisions on the appointment and dismissal of board members.

¹ NPV terms at the completion point under the original framework; and NPV terms at the decision point under the enhanced framework.

² Under the enhanced HIPC Initiative, the nominal amount of assistance disbursed will include an additional amount corresponding to interest on amounts committed but not disbursed during the interim period, calculated using the average return (during the interim period) on the investment of resources held by, or for the benefit of, the PRGF-HIPC Trust.

IX. Exchange Arrangements:

The exchange rate of the Malawi kwacha is a managed-float. On June 27, 2006, the exchange rate was MK 138.99 = US\$1.00.

X. Article IV Consultation:

Malawi is on the standard 12-month Article IV consultation cycle. The last Article IV consultation (Country Report 04/380) was concluded by the Executive Board on October 18, 2004.

XI. Technical Assistance:

Date	Duration	Dept.	Recipient	Purpose	Form
9/01	1½ weeks	FAD	Ministry of Finance	Expenditure tracking and fiscal ROSC	Mission
11/01	2 weeks	MAE	RBM	Monetary operations and further developing financial markets	Mission
02/02	2 weeks	FAD	Ministry of Finance	Expenditure policy	Mission
05/02	6 months	FAD	Ministry of Finance	Expenditure management	Advisor
07/02	2 weeks	STA	National Statistical Office (NSO), RBM	GDSS Anglophone project on national accounts statistics	Mission
08/02	2 weeks	STA	RBM	Monetary and financial statistics	Mission
02/03	2 weeks	MAE	RBM	Monetary operations, payments system, banking supervision	Mission
08/03	2 weeks	STA	NSO	GDSS Anglophone project on balance of payments statistics	Mission
09/03	2 weeks	STA	NSO, Ministry of Finance, RBM	ROSC on the quality of macroeconomic data	Mission
02/04	2 weeks	MFD	RBM	Monetary operations, credit quality assessment, payments system, banking supervision	Mission
04/04	2 weeks	STA	RBM	Monetary and financial statistics	Mission
01/05	2 weeks	LEG/MFD	RBM	AML/CFT	Mission
03/05	2 weeks	FAD	Ministry of Finance	Tax Policy Mission	Mission
08/05	1 week	STA	Ministry of Finance	GDSS project on fiscal sector	Mission
11/05	1 week	FAD	Ministry of Finance	Civil service pensions	Mission
12/05	2 weeks	MFD	RBM	Monetary operations, banking supervision, payments systems, and forex bureaus	Mission

XII. Resident Representative:

Mr. Thomas Baunsgaard since August 16, 2004.

APPENDIX III—MALAWI: IMF-WORLD BANK RELATIONS

Contact person: Ms. Yisgedullish Amde, Tel. 202 473 2203

A. World Bank Country Assistance Strategy (CAS)

1. The Malawi CAS was approved by the Bank's board on May 14, 2003. The gray cover report (Report # 25906 MAI) outlined the current social, economic, and political situation in Malawi and proposed strategies for the next three years (FY04–06), based on the lessons learned from the previous strategies. This strategy presents a transitional program that aims to help the government to address urgent development issues. Preparation for a new CAS has begun and will be completed in the coming Fiscal Year (FY07).

2. The current CAS program is organized under three pillars: i) strengthening economic management; ii) establishing a platform for growth; and iii) improving service delivery and strengthening the safety net. Two ongoing projects (Financial Management Transparency and Accountability and Privatization and Utility Reform¹), and a Structural Adjustment Credit (Fiscal Management and Accelerating Growth Project²) aim to assist Malawi in attaining the objectives under pillar one. In addition, in response to the drought-induced emergency in early 2005, an Emergency Recovery Grant was approved in September 2005 to support the restoration of assets and production. To support the objectives of pillar two, the ongoing Community Based Land Reform; Irrigation, Rural Livelihoods Road Maintenance, and Rehabilitation; and Road Maintenance and Rehabilitation Projects, well as the just-approved Rural Infrastructure Services Project are under the base case. The World Bank also supports Malawi's participation in the Southern Africa Power Market Project, which contributes to the achievement of pillar two. Core Bank interventions under pillar three include the HIV/AIDS (MAP) Project, Third Malawi Social Action Fund Project; Secondary Education Project (since closed in December 2005), and two new Projects, First Education Sector Support Project, and Health Sector Program with a sector-wide approach (the first in Malawi). A Malaria Booster Project, is in the pipeline for July 2006. Finally, Malawi also benefits from the Bank-funded Regional Trade Facilitation Project, which contributes to poverty alleviation through private-sector-led growth by improving access to financing for productive transactions and cross-border trade.

¹ Global Development and Learning Network Project was cancelled in November 2005 per the Government's request.

² The Fiscal Management and Accelerating Growth Project was slated to close on June 30, 2006.

B. Financial Relations with the World Bank Group

3. The World Bank has been active in Malawi since 1966. Total lending and grants to Malawi from the World Bank as of June 2006 is US\$2,705 million, of which US\$2,498 million has been disbursed. As of June 2006, there were 13 active projects in Malawi with a net commitment of US\$393.6 million and an undisbursed balance of US\$144 million. Sectoral breakdown is as follows: Rural at 19 percent, Transport at 8 percent, Public and Private Sector Development and Finance at 38 percent, and Social Sectors at 36 percent.

4. IFC has two investments in Malawi, with 44 percent in capital markets and the balance in health, totaling US\$1.16 (US\$0.64 million in loans and US\$0.52 million in equity). Future focus will be on expanded IFC assistance for the private sector, especially in manufacturing, mining, and tourism, areas that Malawi has chosen as targets to reduce its dependence on agriculture.

C. Areas in Which the Bank Leads

Education and Health

5. The Multi-Sectoral AIDS Project (US\$35 million in grants) was approved in FY04. The project will support efforts by the Government of Malawi to reduce HIV transmission and mitigate the impact of the disease throughout Malawian society, thus also fighting the poverty AIDS brings to families and societies. A major study of Malawi's HIV/AIDS problem revealed 10 important constraints that the project, scheduled to begin in 2004 and run through 2008, will address through a range of activities, including capacity building in public, private, and civil society organizations; educational work for prevention; and increased support for AIDS orphans. Many of Malawi's other development partners are also active in this effort, pooling their funds to support this critical effort.

6. The Health Sector Support Project for Malawi (the first project with a Sector Wide Approach in Malawi) aims to improve the effectiveness, efficiency, and equity of Malawi's essential health care delivery system. The project (with US\$15 million in grants), which was approved in December 2004, has the following three components: Component 1. The project will improve the health status of the Malawian population by increasing access to quality essential health services. The main mechanism for delivering quality care would be by making the already-defined Essential Health Package (EHP) accessible to all, especially to the poorest and most vulnerable populations, including those living in rural districts. Component 2. The program will increase the number of staff available through the continuation of the six-year emergency training plan, a concerted recruitment campaign, the financing and filling of current vacancies, the use of volunteers and contractual staff, and other stop-gap staffing strategies. Component 3. The program will improve the effectiveness and efficiency of both the health system and the referral network to support EHP delivery. A supplementary Malaria Booster project to strengthen the Bank's response to Malaria will focus on monitoring and evaluation.

7. The First Education Sector Support Project for Malawi (with US\$32.2 million in grants), approved in May 2005, will provide immediate financing to support the education sector in Malawi. The project has the following six components: Component 1. The project will complement government and donors' efforts to improve quality and expand teacher development and training at all levels. Component 2. The project will improve the conditions of learning at selected secondary schools staffed with trained teachers or newly trained teachers. Component 3. The project will provide a School Health and Nutrition package to all primary schools that will include: distribution of vitamin A and iron-folic acid to school children under 10-years-old, de-worming, treatment of malaria and fever, and the promotion of good health and nutrition practices. Component 4. The project will supply basic learning materials directly to schools while strengthening the participation of communities in school management. Component 5. The project's Capacity Building and Policy Development will cover: (i) national education policy consolidation and capacity building; and (ii) support for the implementation of the government's decentralization policy in education. Component 6. The project will support the physical implementation and management of fiduciary and procurement issues.

Social Protection and Community Development

8. The Malawi Social Action Fund (MASAF) is a long-term, wide-ranging poverty-reduction project that supports decentralization and community capacity building. The project aims to empower individuals, households, communities, and their development partners in the implementation of measures that can assist them in better managing the risks associated with health, education, sanitation, water, transportation, energy and food insecurity, and to provide support to critically vulnerable populations through a variety of sustainable interventions. The current Project, MASAF III (US\$60 million, of which US\$27 million is in the form of an IDA grant) was approved in FY03. The project encourages communities to develop social safety nets for their most vulnerable members (such as skills training for AIDS orphans), facilitates delivery of the most needed social services, and stimulates communities to save and invest.

Infrastructure

9. The Road Maintenance Project (US\$30 million) was approved in FY99 to bring about sustainable improvements in the quality of Malawi's road infrastructure. Such improvements will help economic growth and diversify the economy by reducing transport costs and improving access by: (a) strengthening and restructuring the road sector's institutional framework; (b) reforming the road sector; and (c) addressing the backlog of road maintenance and rehabilitation needs. The Integrated Infrastructure Services Project, which primarily supports rural energy and transport needs was approved on June 27, 2006. In addition, Water (FY07) and Roads (FY08) projects are in the pipeline.

Private Sector

10. Parastatal reform continues to be an urgent need in Malawi. In the past two years, progress has been made with Bank assistance through the Privatization and Utility Reform Project (PURP, US\$28.9 million, approved in FY00). The PURP aims to improve the quality of and access to economic and physical infrastructure, especially telecommunications, water, and power, by promoting greater private-sector involvement. The Government's Privatization Commission identified some 100 public enterprises that should be privatized; the project aims to support the Commission's divestiture work through technical assistance and support for strengthening existing public enterprises, such as the postal service. PURP is currently being restructured to address slow implementation issues, respond to new challenges facing the government, incorporate lessons learned, and improve the program's effectiveness.

11. Malawi also participates in the Regional Trade Facilitation Project, which principally aims to contribute to poverty alleviation through private-sector-led growth in participating countries by improving access to financing for productive transactions and cross-border trade. The project brings together a group of countries by setting up a credible insurance mechanism against losses caused by political risks. The governments of these countries would agree to be the ultimate risk takers in the insurance mechanism, thus creating a strong disincentive to bring claims. The private market currently does not offer this type of insurance, particularly for medium-term transactions (over one year). The project will thus widen the scope for private sector activity by extending the maturities at which credit is available. It will also create a more stable business environment by extending consistent and predictable coverage. Finally, through better risk management, the project will lower the risk premium.

Agriculture

12. A Community-Based Rural Land Development Project (US\$27 million) was approved by the Board in April 2004. Based on positive community-level experience gained through the MASAF projects, and in partnership with the Government and UK's Development agency, DFID, this project will acquire idle land and transfer it to small farmers, thus enabling such farmers to feed their families and try to grow surpluses for commercial sale. It is urgent that Malawi move toward a more equitable distribution of land that will provide food security for small farmers. The Structural Adjustment Credit, FIMAG, also supports agricultural policy reforms (see further details in paragraph 19).

13. An Irrigation, Rural Livelihoods, and Agriculture project (US\$40 million), approved in November 2005, aims to complement other activities on the ground. The overarching development objective of the proposed project is to raise the agricultural productivity and net incomes of poor rural households in target districts by providing an integrated package of support, including irrigation, agricultural/ irrigation advisory services, marketing and post-harvest assets and services, and capacity building.

Environment

14. Direct Bank involvement in the environment sector is currently limited to the Mulanje Mountain Biodiversity Conservation Project (US\$7 million), which was approved in FY01. The Project aims to raise awareness about conservation needs, strengthen the capacity of the Forest Department and of local communities to carry out conservation measures, and encourage more local community participation in managing the forest reserve. In addition, especially within the framework of MASAF, the project promotes environmentally sound community development initiatives and funds community resource management projects.

Poverty Monitoring

15. The Bank is supporting the National Statistical Office with one aspect of the poverty monitoring tasks identified in the Poverty Reduction Strategy Paper (PRSP) as requiring technical assistance. Through the PRSP Trust Fund, the Bank assisted the government in conducting the Second Integrated Household Survey, including design, collection, processing, and dissemination of data covering not only household characteristics, but also community level indicators. A Poverty Assessment is being finalized and will provide an in-depth analysis of the new household data.

D. Areas in Which the Bank and the Fund Share the Lead

Poverty Reduction Strategy

16. The Government of Malawi finalized its PRSP in April 2002. A joint IDA-IMF staff assessment was presented to the Boards of the IMF and the Bank on July 19, 2002, and the Boards subsequently endorsed the strategy in August 2002. The IMF and the Bank staffs maintained a collaborative relationship in supporting the government in the process. The first Annual Progress Report (APR), approved by the Boards in October 2003, indicates that MPRSP implementation was limited. The second APR and Joint Staff Assessment Note (JSAN) for the period July 2003–June 2004, which was submitted to the Boards in July 2005, also indicates that MPRSP implementation has been limited. The third APR (looking at the period July 2004–June 2005) is expected in the mid- 2006.

Debt Sustainability and Enhanced Heavily Indebted Poor Country (HIPC) Initiative

17. Staff of the IMF and the Bank prepared “Malawi: Decision Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative,” which was presented to the Board on December 8, 2000. The total amount of debt relief assistance to Malawi is equivalent to around \$1.0 billion in nominal terms (US\$643 million in net present value terms). Debt relief, provided as 55 percent relief on annual debt service due, will be delivered between January 2001 and December 2020. IDA is the largest creditor to Malawi, accounting for 51 percent of the entire external debt (and 69 percent of multilateral debt).

Budgetary Planning, Revenues Administration, and Public Expenditure Reforms

18. The Bank's assistance in improving public expenditure management has been channeled mainly through its structural adjustment credits. The most recent one, the Fiscal Management and Accelerating Growth (FIMAG, US\$50 million) structural adjustment credit, was approved by the Board, and two tranches of US\$25 million each have been released. The FIMAG program focused on four areas: (i) strengthening public expenditure management, (ii) privatizing state-owned enterprises, (iii) supporting small-holder agriculture and land reform, and (iv) addressing HIV/AIDS.

19. The Financial Management, Transparency, and Accountability Project (FIMTAP, US\$24 million, FY03) is also assisting the government with improving financial management systems and increasing transparency. The main objective of the project is to improve civil service and public expenditure management for better allocation and utilization of public resources.

Civil Service and Wage Reform

20. Following the World Bank–financed study on the review of civil service and wage policy issues, the government has begun implementing the recommendations of the study at the end of 2004, including streamlining the system of allowances, consolidating such allowances in the base for personal income tax, rationalizing salary grades, and moving towards a unified salary structure. These reforms are also supported under the IMF Staff Monitored Program.

Emergency Assistance

21. In addition to technical assistance and the reallocation of existing uncommitted funds as appropriate, an Emergency Recovery Project was approved in September 2005. This project supports the restoration of assets and production following the drought-induced emergency in early 2005 and thus supports the core growth strategy of the macroeconomic program adopted by the new administration in May 2004. This emergency grant provides funds to allow critical private sector imports that support the restoration of assets, investment, and production to take place with minimal disruption to the economy.

E. Areas in Which the Fund Leads

Macroeconomic Stability, Fiscal Policy, and Monetary Policy

22. Malawi is confronted with a number of macroeconomic challenges, including a history of repeated fiscal slippages and unpredictable monetary policies, a rapidly rising level of domestic debt, and a persistently high level of real interest rates. The Fund will work with the authorities to master these challenges, both through financial support and technical assistance.

APPENDIX IV—MALAWI: STATISTICAL ISSUES

1. Malawi's economic statistics show serious deficiencies that have affected program monitoring. A Report on the Observance of Standards and Codes (ROSC) Data Module, published February 17, 2005, found that, while the legal and institutional framework for the production of macroeconomic statistics was broadly adequate, there were shortcomings in the scope, accuracy, and reliability of data as well as scope for strengthening the provisions of the Statistics Act. There is a need to formally assign the responsibility for the compilation of government finance statistics to the Ministry of Finance, and responsibility for the compilation of monetary statistics to the Reserve Bank of Malawi. The authorities are making efforts to improve the quality and timeliness of economic and financial data through participation in the GDDS. As one of fifteen countries participating in the Fund's General Data Dissemination System (GDDS) Project for Anglophone African Countries, Malawi has undertaken to use the GDDS as a framework for the development of national statistical systems. Malawi's metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since December 2002. The Anglophone Africa project (funded by the U.K. Department for International Development (DFID)) aims to assist participating countries with implementing plans to improve the metadata and meet GDDS recommended statistical practices. Since the posting of the original metadata, the fiscal sector and socio-demographic data for health and education were updated in March 2004, and other sectors in February 2005.

Real Sector Statistics

2. Real sector statistics covering the national accounts, prices, and trade statistics need substantial improvements. Only a limited set of source data is available, and quality and timeliness should be improved. The National Statistics Office (NSO) needs additional resources to meet, in particular, the required quality standard of national accounts. A long-term technical assistance program (2004-07) on national accounts is being provided under a project by Statistics Norway.

National accounts

3. The NSO is responsible for compiling the national accounts data. However, while the final estimates are comprehensive,¹⁴ the source data underpinning these estimates are inadequate, due to gaps in coverage, especially for medium- and small-scale establishments, and informal sector activities. Use is not made of relevant surveys and financial statements to prepare estimates of changes in inventories and household final consumption expenditures. Statistical techniques for compilation are deficient, and processes to assess and validate

¹⁴ Covering GDP from the production side at constant prices, GDP by expenditure at current prices, gross national income and its components, national disposable income and use of disposable income, and the capital and financial accounts.

source, intermediate, and final data are generally limited. The national accounts are published in Malawi's *Statistical Yearbook* and *Quarterly Statistical Bulletin* with a significant lag.

Prices

4. A consumer price index (CPI) is available on a timely basis. The CPI is based on the 1997/98 household survey, and data are collected on a monthly basis by regional price collectors. The effectiveness of the index could be improved by using the geometric mean as the elementary aggregate index formula and by applying systematic, comprehensive, and consistent approaches to the quality adjustment of product prices.

Trade

5. Preliminary estimates of trade are now available with a lag of two to three months. Trade data are received electronically from six major ports. The adjustment of imports from c.i.f. to f.o.b. prices is not appropriate and there is no reconciliation with neighboring countries.

Government Finance Statistics

6. Malawi reports some fiscal data on a cash basis to AFR. Although administrative records are kept on a manual basis, the systems are designed to provide adequate information. However, there are serious quality problems, including data inconsistencies, that complicate program monitoring:

- While **tax revenue data** are received in a timely fashion, it is not always possible to reconcile them with deposits in the MG Account No. 1.
- **Nontax revenue** collected by line ministries is not properly accounted for in the fiscal reports prepared by the Ministry of Finance. It also includes capital revenue.
- Data on **recurrent expenditure** suffer from serious shortcomings partly related to insufficient bank reconciliation at the level of line ministries (between spending records and financing information). The fiscal reports prepared by the Ministry of Finance show spending based on funding data (from the Credit Ceiling Authority). Line ministries subsequently submit spending reports to the Ministry of Finance based on recorded expenditure. At times there are sizable discrepancies between these two sources of data for both wages and other recurrent transactions—to some extent reflecting the widespread practice of reallocation across budget lines.
- Domestically-financed **development expenditure** is based on funding released to line ministries, and data on externally-funded expenditure are based on reported project grants and loans. Owing to differences in timing and

financing modalities (e.g., some donors require prefinancing of expenditure before reimbursement), there are substantial differences between the flow of expenditure and corresponding financing data. Thus, there are substantial errors in the reporting of capital spending. Also, many donor projects are still not incorporated in the budget, and hence the corresponding expenditure is not captured. Some externally funded development expenditures are likely recurrent and, reported capital expenditure could be inflated.

- Data on **expenditure arrears** are likely incomplete, as reporting from the Commitment Control System appears to be only partial, and ministry level data are not consistent from report to report. Previously unknown arrears have repeatedly been cleared through the “special activities” vote, thus calling into question the accuracy of arrears data and the data on clearances.
- The **budget classification and chart of accounts** may be adequate for some administrative, economic, functional and program classifications. An output-oriented activities-based budget classification (ABB) is used for the presentation of the budget. However, **pro-poor expenditures** that are protected in line with the PRSP are only identified in the ABB classification. As no bridge table exists to map the ABB classification into the program classification used for expenditure reporting and accounting, pro-poor expenditures cannot be monitored.
- **Financing estimates** are based on monetary and debt data, rather than on government records of financing. Reporting on treasury bills directly issued to the RBM at times has been slow.

7. The authorities have received significant technical assistance from the Fund and other donors to strengthen expenditure monitoring and reporting, accounting, and statistical reporting, but results have been disappointing. The new government has pledged to strengthen public financial management and fiscal reporting, and renewed efforts are being made to establish a work plan, including effectively utilizing donor technical assistance.

8. Malawi does not report government finance data for inclusion in the *Government Finance Statistics Yearbook (GFSY)* or the *International Financial Statistics (IFS)*. A STA mission visited Lilongwe in August 2005 to review progress on major issues raised during previous missions. The mission reiterated the importance of continued efforts to implement an Integrated Financial Management Information System (IFMIS), to improve the coverage and sectorization of government financial operations and to correctly classify transactions according to international guidelines. Although the mission assisted the authorities with the compilation of annual fiscal data for 2003/04 in accordance with the *GFSY* Questionnaire, such data have yet to be reported for inclusion in the publication. The mission proposed, and

discussed with the authorities, a migration plan and timetable to adopt the *GFSM 2001* methodology.

Monetary and Financial Statistics

9. The Reserve Bank of Malawi (RBM) reports monetary and financial statistics (MFS) to STA on a regular basis.

10. The MFS mission that took place in April-May 2004 noted that significant progress was achieved in implementing the recommendations made by the MFS mission conducted in August-September 2002. One of the most notable achievements was the improved coverage of the monthly monetary survey that now accounts for more than 90 percent of the banking sector. On the other hand, the mission also noted that some important recommendations were yet to be implemented, such as the sectorization of the domestic economy, and classification of financial instruments to ensure that the MFS of the RBM adhere fully to the methodology of the *Monetary and Financial Statistics Manual*.

11. Concurrently, the mission completed the development of an integrated database that will be used by the RBM, STA, and AFR for publication and operational needs. The mission also discussed the standardized forms (SRF) that are being adopted by all countries for reporting monetary data to STA. The authorities submitted the SRF test data; however, there has not been further progress after STA provided comments on these test data in October 2005.

External Sector Statistics

12. Concepts and definitions used to compile the balance of payments statistics are in broad conformity with the guidelines presented in the fourth edition of the *Balance of Payments Manual (BPM4)*. The NSO has made progress in the transition to the methodology of *BPM5*. The most recent data reported to STA for publication in the *Balance of Payments Statistics Yearbook* pertains to 2002. Mainly as a result of the liberalization of exchange controls, the compilation of data relies on balance of payments surveys as the source of information for major components in the balance of payments, such as services, direct investment flows, and other financial transactions of the private sector. Data from primary sources (surveys and/or International Transaction Reporting System reports) are supplemented with information from secondary data sources, such as foreign trade statistics collected by the MRA through customs declarations, debt statistics from the MOF, net foreign assets from the RBM, and information on grants collected from main donors.

**MALAWI: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(AS OF JULY 5, 2006)**

	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶	Memo Items:	
						Data Quality – Methodological Soundness ⁷	Data Quality – Accuracy and Reliability ⁸
Exchange Rates	27/06/06	27/06/06	D	W	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	12/05	01/06	M	M	M		
Reserve/Base Money	06/06	06/06	D	W	M	LO, LO, LO, LO	LO, O, O, O, O
Broad Money	1/06	6/06	M	M	M		
Central Bank Balance Sheet	4/06	6/06	W	W	Q		
Consolidated Balance Sheet of the Banking System	4/06	1/06	M	M	M		
Interest Rates ²	4/06	6/06/06	W	W	W		
Consumer Price Index	05/06	06/06	M	M	M	O, LO, O, O	LO, LO, LNO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government	NA	NA	NA	NA	NA	LO, LNO, LNO, LO	LNO, O, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	11/05	12/05	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/03	07/04	M	NA	NA		
External Current Account Balance	11/04	04/05	A	Q	A	LO, LO, LNO, LO	LNO, LNO, LO, LO, LO
Exports and Imports of Goods and Services	2005	6/06	A	A	A		
GDP/GNP	2005	6/06	A	A	A	LO, LO, LNO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	12/03	07/04	M	NA	NA		

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

⁷ Reflects the assessment provided in the data ROSC (published February 17, 2005, and based on the findings of the mission that took place September 1–16, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

⁸ Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment, and revision studies.



Press Release No. 06/186
FOR IMMEDIATE RELEASE
August 31, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review of Malawi's Three-Year PRGF Arrangement and Approves US\$7.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed the second review of Malawi's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of the review, enables the release of an amount equivalent to SDR 4.9 million (about US\$7.3 million), bringing total disbursements under the arrangement to SDR 15.3 million (about US\$22.7 million).

The Executive Board approved the three-year arrangement on August 5, 2005 (see [Press Release No. 05/188](#)), for a total amount of SDR 38.2 million (about US\$56.8 million) to support the government's economic program for 2005-2007.

In commenting on the Executive Board's discussion on Malawi, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

“Malawi’s economy has performed well under the PRGF-supported program even in the face of a severe food crisis. Increased public spending was required to avert a humanitarian catastrophe, but overall fiscal performance was satisfactory. Implementation of structural measures, however, remains uneven.

“Monetary policy has been restrained, and this has helped to reduce inflation. The implementation of a more flexible exchange rate policy has helped to clear arrears on import payments. It will be important to sustain this policy going forward to prevent a return to arrears on import payments and to protect Malawi’s relatively low level of international reserve cover.

“The program objectives for 2006/07 are realistic, and the program’s emphasis on structural reforms in public financial management and in the financial sector is appropriate. The authorities’ continued commitment to fiscal discipline and reducing the domestic debt burden will be critical for long-term fiscal sustainability. Looking ahead, it will be important to step up efforts to strengthen expenditure management to ensure that resources freed up by debt relief are used effectively, and to move forward with structural reforms in public financial management and in the financial sector.

“The realization of higher growth rates to reduce poverty over the medium term is an urgent priority. The authorities will also need to maintain prudent monetary policy, and remain vigilant in containing inflationary pressures. Further progress is needed to strengthen governance, improve transparency, and tackle corruption decisively, including by ensuring the independence of the institutions of governance. Continued implementation of strong policies will be critical to shield the economy from domestic and external shocks and improve Malawi’s medium- and long-term prospects,” Mr. Kato said.

**Statement by Peter Gakunu, Executive Director for Malawi
and Joseph L. Masawe, Advisor to Executive Director
August 30, 2006**

The Malawian authorities welcome the Board's discussion on the second review of Malawi's three year PRGF arrangement with the Fund and express their appreciation to the Fund Board and Management, and the international community for their continued support. They also thank staff for preparing well balanced reports on the second review, the HIPC Completion Point and the Joint Staff Advisory Note. My authorities request the completion of the second review, the third disbursement under the PRGF arrangement and waivers for non-observance of structural performance criteria on the budget ceilings module in the payment system and the new travel policy. Government efforts to fully implement the budget ceilings module were overtaken by the roll-out of the Integrated Financial Management Information System (IFMIS) and the centralized payment system.

The authorities remain committed to the macroeconomic policies under the economic program supported by the PRGF arrangement. Apart from the good track record established under the PRGF arrangement, all HIPC completion point triggers were satisfactorily implemented and hope that the Board will approve Malawi's advancement to the HIPC completion point.

My authorities appreciate the candid exchange of views they have had with staff during the discussions on the program. They have taken note of staff's comments in the reports and broadly agree with the analysis, findings and recommendations made and authorize the IMF to make all the documents available to the public including through the IMF internet website.

Recent Economic Developments

Preliminary information indicates that during 2005/06, GDP growth will reach 5.3 percent, in line with projections. However during the review period, the food crisis remained severe, worsening beyond projected levels and therefore impacting more negatively on the economy than projected and affecting the realization of macroeconomic targets. Despite the difficulties, crop estimates for 2006 are encouraging and could result in a significant rebound in GDP growth to around 7 percent. A tight monetary policy stance assisted by the expected good harvest, should be able to bring down inflation to around 7.9 percent over the same period.

Fiscal Policy

Fiscal performance through the second quarter was encouraging, mainly following better than projected revenue performance. During the fourth quarter of 2005/06, tax revenues outpaced projections. Recent fiscal data shows that tax revenue for 2005/06 fiscal year was 0.7 percent of GDP higher than projected. The good revenue performance was further boosted by the receipt of debt service refunds from the AfDB as a component of the interim HIPC assistance.

However, during the third quarter, food security outlays were stepped up to avoid a humanitarian crisis, following shortfalls in donor inflows. The authorities implemented measures aimed at controlling expenditure, which included updating employee database and completing the wage schedule for government employees. These measures led to significant reduction in wage overrun, although the government still could not meet its domestic borrowing target as a result of increased food security outlays.

The authorities implemented new policies on housing, the use of government vehicles and administrative measures to prevent new utility arrears. A draft travel policy has been completed and a Cabinet paper is now being prepared. It is expected that the policy will be implemented beginning October 2006.

The authorities continued to implement measures aimed at improving public financial management. In this context, the government phased in a new Integrated Financial Management Information System (IFMIS) and centralized payment system. They would like to thank the Fund for the technical support it provided in meeting this objective. The implementation of the IFMIS enabled the government to publish reports on the budget and expenditure arrears, which was also a benchmark under the program.

The government remains committed to its policy of zero tolerance on corruption and recognizes that the Anti-Corruption Bureau (ACB) should operate without undue political interference.

Monetary and Financial Policies

Monetary policies continued to be directed towards the primary objective of price stability, while market determined interest and exchange rates were maintained. Reserve money, which is the operational target of the Reserve Bank, continued to be monitored closely. Without prejudice to its primary objective, the Reserve Bank continued to ensure that it accumulates foreign reserves as targeted under the program. To reduce the wide spread between commercial bank's deposit and lending rates, the Reserve Bank lowered the liquidity reserve ratio (LLR) for banks in February 2006. The lowering of the LLR was also in line with the policy of shifting away from the use of direct instruments of monetary policy, to more market based ones. As expected, this move led to a temporary increase in liquidity in the banking system, but this was ably neutralized through increased liquidity mop up by the Reserve Bank.

Over the period, the authorities remained committed to a flexible exchange rate regime, with interventions being limited only to smoothing short term volatility in the exchange rate. Volatility in the exchange rate in Malawi has primarily been caused by the shallowness of the market and seasonality in foreign exchange inflows which is mainly determined by the seasonality of agricultural exports. Efforts to reduce the backlog of unpaid import invoices were deepened by the authorities, although this became challenging, given the limited foreign exchange in the market. We would like to clarify that the Malawi authorities do not practice any exchange restrictions. While it is admitted that there has been a back log in meeting the demand for foreign exchange, it should be understood that this has been caused by

unavailability of foreign exchange in the market, rather than deliberate restriction by the authorities. Import demand has recently gone up following increases in oil prices and increased food security imports following the countrywide drought which caused food shortages. Malawi abides fully with the obligations of Article VIII and has no administrative exchange restrictions on current account transactions. Similarly, the authorities do not implement multiple currency practices. It is worthwhile mentioning that the import backlog has since continued to decline gradually over time. By end June 2006, the backlog was estimated at US\$ 12.7 million and by mid July, it had been eliminated. The Reserve Bank of Malawi continues to monitor the situation in commercial banks and as of August 25, 2006 the report received from RBM shows that there was no import backlog in the banking system.

The spread between commercial banks' exchange rate and that of the foreign exchange bureaus is caused by the market transactions costs and does not therefore constitute multiple currency practice. As retailers, foreign exchange bureaus cannot be expected to charge the same prices as commercial banks.

The authorities continued to implement measures aimed at improving financial intermediation. Consistent with international best practice, an impact analysis of commercial bank balance sheets using asset classification, which was also a structural benchmark under the program, was completed. Based on the new classification, the authorities have issued new directives to banks, governing classification and provisions. In line with the spirit of improving efficiency in the banking system and allowing inefficient banks to exit the market, the authorities have initiated liquidation procedures for the Finance Bank, which was closed and placed under the RBM in mid 2005, due to lack of a suitable buyer.

Policies for 2006/07 and Way Forward

The thrust of government policies will continue to be focused towards implementing the objectives of the PRGF arrangement. While it is expected that GDP growth will substantially improve over the coming year, with inflation being further subdued, more efforts will be directed towards ensuring broader macroeconomic achievements. The government has shown great resilience in implementing the program even though it holds a minority position in parliament, facing intense political pressures. The success of having the budget approved by Parliament, clearly demonstrates the authorities' commitment to the program in the years ahead.

The thrust of fiscal policy will continue to be directed towards improving the tax regime and controlling expenditure. To this end, the authorities will seek to limit wage increases to compensate for overruns in the previous years. Similarly, the government, through the privatization commission, will restructure the Malawi Development Corporation (MDC) following its poor record of performance. As spelt out in the Assessment and Action Plan for HIPC, the Malawi authorities will ensure that improvements are made towards attaining greater budget comprehensiveness, internal control, budget reconciliation and auditing. The government will closely monitor the implementation of the IFMIS and ensure that the Government Finance Statistics module is in place in the few months ahead. The authorities

appreciate the willingness of the Fund and the U.S. Millennium Challenge Threshold program to provide assistance in achieving this objective.

The primary objective of monetary policy will continue to remain the pursuit of price stability, through reserve money programming. It is expected that strict adherence to this objective will help bring inflation further down and improve other macroeconomic variables. The Malawian authorities remain committed to a flexible exchange rate policy. They will continue to strengthen exchange rate management, so as to ensure that the regime remains a truly flexible one.

HIPC Completion Point and MDRI

My authorities appreciate staff assistance in its efforts to fulfill the requirements for reaching the HIPC Completion Point. Reaching the HIPC Completion point will also enable Malawi to receive further debt relief under the MDRI. The 2006/07 fiscal program includes a flow of MDRI related debt relief from the Fund, IDA and the World Bank and AfDB amounting to US\$ 50 million. Once approval is given by the Board for Malawi to reach the completion point under the enhanced HIPC Initiative and considered for topping up under the Initiative, savings arising there from will be used to increase pro-poor spending. They will also fully cooperate with the Fund in ensuring, through continuous monitoring, that all savings and additional resources that will be obtained from the two initiatives are properly utilized.

The Joint Staff Advisory Note (JSAN)

The third Annual Progress Report (APR) of Malawi's Poverty Reduction Strategy (MPRS), for the period July 2004 to December 2005 has been circulated by the government to the Boards of IMF and the World Bank. We thank the Fund and Bank staff for their encouraging and very positive comments on the APR in their Joint Staff Advisory Note (JSAN). The authorities are committed to ensure that more efforts will be directed towards improving future reviews.

As appreciated by staff, the government's strategy continues to focus on poverty reduction, through a stable macroeconomic environment. My authorities will continue to put special emphasis on cross cutting issues, including gender, empowerment, HIV/AIDS as well as science and technology. We would like to reiterate that the Malawian authorities have noted all staff comments on the APR as brought out in the JSAN and promise to use the advice to improve the MPRS, including ensuring broader public participation in the review process.

Conclusion

The Malawian authorities remain committed to the successful implementation of the PRGF supported economic program. The implementation of the program for the review period has been in line with the set objectives and targets. Despite a number of exogenous shocks which impacted negatively on the program, including the need for additional spending to address the state of food shortage and higher cost arising from higher oil prices, the government implemented measures which ensured that the program remained on track.

Going forward, my authorities will continue to take measures to ensure the success of the program. Reducing poverty remains the major objective of government's medium term policy, and hence the need to maintain macroeconomic stability. Fiscal policy will remain supportive to the structural reform agenda, while ensuring that revenue is enhanced and expenditure is streamlined. The authorities will ensure that inflation is further brought down and the financial system becomes more supportive to economic activity and resilient to shocks. In this connection, measures to strengthen and deepen financial markets will continue to be implemented.

My authorities look forward to reaching the HIPC Completion point, and hope that they will continue to enjoy the support and encouragement of the Fund. On the basis of the performance during the period under review and measures to be implemented during the remaining period of the fiscal year, my authorities request the completion of the second review under PRGF arrangement.