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MALAWI

May 2013

SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—STAFF REPORT; STAFF SUPPLEMENT; PRESS RELEASE ON THE EXECUTIVE BOARD DISCUSSION; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI.

In the context of the second review under the Extended Credit Facility Arrangement and request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- **Staff Report** for the Second Review Under the Extended Credit Facility Arrangement and Request for Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on February 28, 2013, 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 March 29, 2013. 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.

- **Informational Annex** prepared by the IMF.

- **Press Release**, summarizing the views of the Executive Board as expressed during its April 8, 2013 discussion of the staff report that completed the review.

- **Statement by the Executive Director** for Malawi.

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

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

*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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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

MALAWI

March 29, 2013

SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

The authorities remain committed to the policy reforms they have been implementing since May 2012. Notwithstanding growing public complaints and protests about the rising cost of living, the authorities reiterated their commitment to stay the course of policy reforms to the Managing Director of the Fund when she visited Malawi in early January 2013. While they have made concessions in response to political and social pressures (e.g., the recent wage increase to striking civil servants), the cornerstones of the reforms—the market based exchange rate regime and automatic adjustment mechanism for fuel prices—have remained unchanged.

The policy reforms have begun to yield some positive results. Increased availability of foreign exchange—including through the re-establishment of external credit lines—has regularized the supply of fuel and allowed increased imports of inputs for production. A broad spectrum of private sector stakeholders met by the mission noted a significant increase in the cultivation of export crops during the current season which, combined with good rains so far, bodes well for a good harvest beginning in March/April.

Prices and the exchange rate are both expected to stabilize with the onset of the food harvest and the tobacco purchase season. Year-on-year inflation reached 34.6 percent in December 2012, reflecting the impact of the depreciation of the exchange rate and a contraction in food production last season. The kwacha has depreciated by an additional 33 percent against the U.S. dollar following the initial 33 percent devaluation in May 2012.

Policy continuity is critical for curbing inflation and for a sustained recovery. Policy discussions focused on measures to maintain a tight monetary policy until inflation pressures recede, and on the need for fiscal restraint to contain aggregate demand in order to stabilize the exchange rate and begin to accumulate international reserves. Risks to the program include adverse weather conditions and policy reversals in the lead up to the 2014 general elections. Policy reversals would jeopardize the prospects for recovery and sustained growth.

Performance in relation to program targets has been broadly satisfactory. All the quantitative performance criteria for end-December 2012 were met, while the indicative targets on reserve money and social spending were missed by small margins. Progress on the implementation of structural reforms has also been satisfactory.

Staff recommends completion of the second review, based on performance thus far and on the authorities' policy commitments.

Approved By
David Owen and Dhaneshwar Ghura

Discussions were held in Lilongwe and Blantyre during February 5–19, 2013. The mission was led by Mr. T. Tsikata (AFR), and included Messrs. O. Adedeji and M. Ghazanchyan and Ms. J. Peng (all AFR), Mr. M. Raissi (SPR), Mr. A. Mialou (STA), and Ms. R. Randall (Resident Representative). The mission met with Minister of Finance Dr. Ken Lipenga, Minister of Economic Planning and Development Mr. Goodall Gondwe, Governor of the Reserve Bank of Malawi Mr. Charles Chuka, Chief Secretary Mr. Bright Msaka (Office of the President and Cabinet), Secretary to the Treasury Mr. Randson Mwadiwa, other senior government and RBM officials, representatives of civil society organizations, financial institutions, private sector enterprises, trade unions, and Malawi's development partners. Ms. H. Teferra (OED) participated in the discussions, and the mission was assisted by Mr. S. Banda (Economist in the office of the IMF Resident Representative).

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STAYING THE COURSE OF POLICY REFORMS TO ACHIEVE MACROECONOMIC STABILITY AND ECONOMIC RECOVERY

1. **The authorities remain committed to the policy reforms they have been implementing since May 2012.** The key measures to address acute foreign exchange shortages and growing government imbalances were adoption of a flexible market-based exchange rate regime, and re-introduction of an automatic adjustment mechanism for fuel prices to keep them in line with import costs and safeguard government revenues. Continued depreciation of the exchange rate and a drought-induced contraction in agricultural output slowed down growth and contributed to a spike in inflation in 2012. Notwithstanding growing public complaints and protests about the rising cost of living, the authorities reiterated their commitment to stay the course of policy reforms to the Managing Director of the Fund when she visited Malawi in early January 2013. While they have made concessions in response to political and social pressures (e.g., the recent wage increase to striking civil servants), the cornerstones of the reforms—the market based exchange rate regime and automatic adjustment mechanism for fuel prices—have remained unchanged.

2. **The main objectives of the ECF-supported program are achievement of macroeconomic stability, strengthening social protection programs, improving growth prospects and reducing poverty.** These are based on the Malawi Growth and Development Strategy (MGDS II) and are in line with the government's Economic Recovery Plan. The Executive Board approved a new three year ECF arrangement for Malawi in July 2012 in the amount of SDR 104.1 million (150 percent of quota). The first review of the program was completed on December 19, 2012. The Fund-supported program has catalyzed financial assistance from donors to support the FY2012/13 budget, with an emphasis on scaling up social protection programs.

3. **After a slow start, measures to cushion the adverse impact of austerity measures and exogenous shocks on poor households were successfully rolled out.** In particular, implementation of social-protection programs contained in the FY2012/13 budget—the farm input subsidy program, labor-intensive public works, school feeding, school bursary, and social cash transfer—accelerated in the fourth quarter of 2012. An emergency relief operation being coordinated by the World Food Program (WFP) has provided assistance to about 2 million people facing food deficits during the lean season (October–March). The government authorized the release of 72,000 metric tons of maize from the national Strategic Grain Reserve as part of its contribution to the relief effort.

4. **The policy reforms have begun to yield some positive results.** Adjustment of the grossly overvalued exchange rate and the removal of restrictions on foreign exchange transactions have attracted foreign exchange inflows into the banking system. This helped clear most of the external payments arrears accumulated by the private sector over the last few years, and facilitated

the re-establishment of international credit lines for critical imports to enhance capacity utilization. There are also indications that farmers have expanded the planting of various export crops.

5. **Structural reforms are needed to improve the investment climate and boost exports.** The government is taking steps to enhance Malawi's international competitiveness by removing regulatory hurdles to doing business and undertaking investments in infrastructure to remove bottlenecks holding back growth and diversification of the economy.

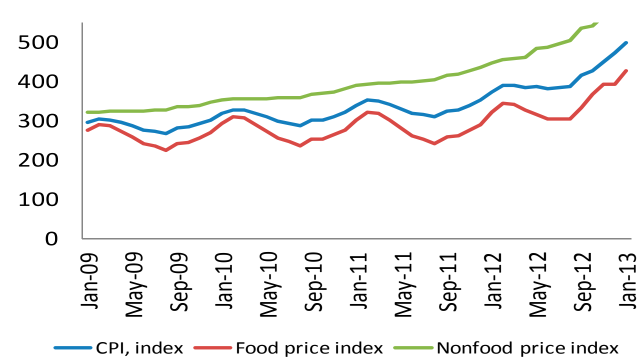
RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

A. Recent Economic Developments

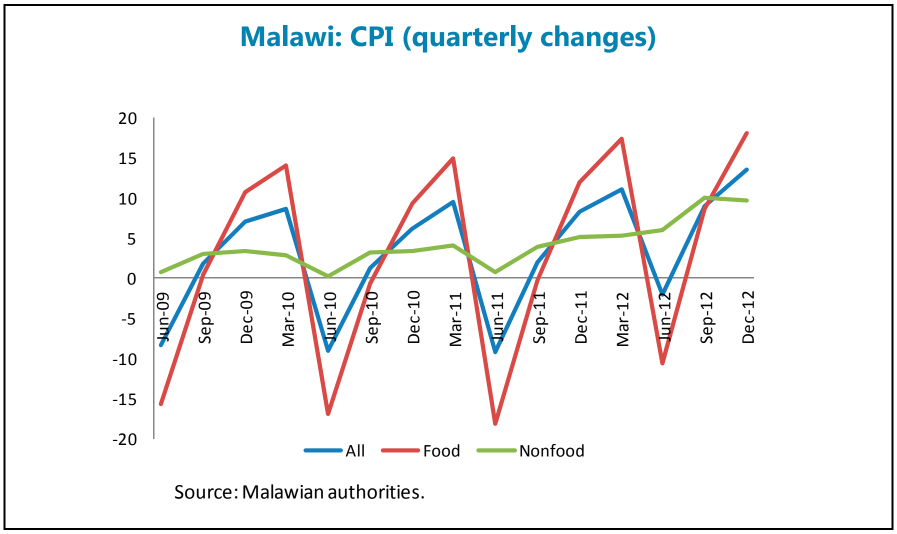
6. **Economic growth slowed considerably in 2012.** Real GDP growth is estimated to have slowed from 4.3 percent in 2011 to 1.9 percent in 2012, mainly reflecting a contraction in agricultural output (Table 1 and Figure 1). Adverse weather conditions in parts of the central and southern regions of the country resulted in a decline in the output of maize (the main staple crop). Tobacco output also contracted sharply in 2012, reflecting poor price incentives associated with the period of marked overvaluation of the exchange rate. A rebound in growth is expected in 2013, premised on improved price incentives for tobacco and other export products, increased availability of foreign exchange, and a return to normal rainfall patterns.

7. **Inflation has been rising, reflecting the impact of the large devaluation in May 2012, continued depreciation of the exchange rate, and a spike in food prices due to the decline in domestic food production.** On a year-on-year basis, headline consumer inflation increased from 12.4 percent in April to 34.6 percent in December 2012 (Figure 1). Based on the seasonal pattern of price movements (see Text Charts below), inflation is expected to start declining in the second quarter of 2013; last year's seasonal price decline was unusually small because of bad weather and this year's is expected to be larger because of better weather. The lagged impact of tighter policies is also expected to contain non-food inflation.

Malawi: CPI Monthly Index (level), January 2009–January 2013



Source: Malawian authorities.



8. **Recent further depreciation of the kwacha reflects excess demand for foreign exchange that is expected to subside with the onset of the tobacco purchase season.** The kwacha has depreciated by an additional 33 percent against the U.S. dollar following the initial 33 percent devaluation in May 2012. In recent months, the principal source of demand for foreign exchange has shifted from the clearance of a large backlog of private sector external payments arrears (estimated at over US$600 million) to current imports of goods and services. Poor earnings from tobacco and sugar in 2012 constrained the supply of foreign exchange, and low official international reserves contributed to market perceptions of continued scarcity of foreign exchange. The exchange rate is expected to stabilize with the onset of the tobacco purchase season in March/April 2013 as the supply of foreign exchange to the local market improves.

9. **Overall fiscal performance during the first half of FY 2012/13 (July–December 2012) was broadly in line with the program** (Text Table 1 below). Domestic revenues were slightly higher than projected, with income tax and taxes on international trade performing better than expected. Total grants fell short of projections by about MK8 billion (0.7 percent of GDP or over US$20 million) due to delays in meeting conditions for disbursement. The conditions (related to submission of action plans and making specific requests for disbursements) have now been met and dedicated grants are expected to be fully disbursed by the end of the year. The shortfall in dedicated grants translated into lower spending by the National AIDS Commission and the education sector. Similarly, lower disbursement of external loans resulted in lower-than-projected development expenditure in the education sector. Disbursements of these grants and loans are expected to pick up in the second half of the year.

Text Table 1. Fiscal Performance in the First Half of 2012/13

(Billions of kwacha)

	Mid-Year Prog.	Mid-Year Act.
Revenue	243	238
Tax and nontax revenue	133	136
Tax revenue	119	121
Nontax revenue	14	15
Grants	110	102
Expenditure and net lending	250	243
Current expenditure	195	191
Development expenditure	55	51
Part I (foreign financed)	32	28
Part II (domestically financed)	22	23
Discrepancy	14	16
Overall balance (including grants and discrepancy)	7	11
Total financing (net)	-7	-11
Foreign financing (net)	11	7
Domestic financing (net)	-18	-18

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] The discrepancy includes a carry-over of revenues from FY2011/12, which was used in 2012/13 to retire unbudgeted borrowing in the last quarter of FY2011/12.

10. **Money growth slowed in the second half of 2012, reflecting a tightening of monetary policy and improved fiscal performance.** Using a range of instruments—foreign exchange sales, reduced lending to banks, open market operations, and raising the policy rate—the RBM succeeded in slowing growth in reserve money from 37.3 percent during the first half of 2012 to -1.2 percent during the second half of 2012 (Text Table 2). RBM lending to banks fell sharply with the closure of the uncollateralized lending window at the end of November. Reserve money growth also decelerated on a year-on-year basis (Table 3a and Figure 3b). Broad money growth fell from 13.4 percent during first half of 2012 to 8.4 percent during the second half (Text Table), emanating from reduced domestic borrowing by the government from the banking system and slower growth in lending to the private sector (Text Table 3). Broad money growth also decelerated substantially on a year-on-year basis (Table 3b and Figure 3b).

Text Table 2. Reserve Money

(6-month growth, percent)

	Dec.11–Jun. 12	Jun. 12–Dec.12
Reserve money	37.3	-1.2
Net Foreign Assets	-46.8	23.0
Net Domestic Assets	84.1	-24.2
Credit to government	45.6	-25.7
Credit to statutory bodies	0.0	0.0
Other Items Net	38.5	1.5
Lending to banks	27.2	-19.8
Placement	1.1	12.9

Source: Calculated from data provided by RBM.

Text Table 3. Broad Money

(6-month growth, percent)		
	Dec.11–Jun. 12	Jun. 12–Dec.12
Broad money	13.4	8.4
Net Foreign Assets	-2.0	9.9
Net Domestic Assets	15.5	-1.5
Credit to government	9.1	-8.1
Credit to statutory bodies	-0.9	0.6
Credit to private sector	10.6	3.1
Other items net	-3.3	2.8

Source: Calculated from data provided by RBM.

11. **The current account deficit is estimated to have narrowed from about 6 percent of GDP in 2011 to about 4½ percent in 2012, arising largely from increased official transfers** (Tables 4a and 4b, and Figure 4). Export performance in 2012 reflected the lingering effects of economic distortions of the previous few years. The volume of tobacco sales on the auction floor in 2012 was about 67 percent of the amount sold in 2011, as production of tobacco contracted significantly. Sugar exports also declined as a result of drought in central and southern parts of the country. International reserves and the associated import coverage ratio improved slightly from exceptionally low levels in the first half of 2012 to just above 1 month of imports cover at end-December 2012.

12. **Exporters are allowed to retain a larger share of their earnings in foreign currency denominated accounts.** In February 2013, the RBM increased the share from 60 percent to 80 percent. Correspondingly, the share that must be sold to banks was reduced from 40 percent to 20 percent.

B. Performance under the Program

13. **Performance in relation to program targets has been broadly satisfactory.** All the quantitative performance criteria for end-December 2012 were met, while the indicative targets on reserve money and social spending were missed by small margins (Table 8a). The authorities are making steady progress in implementing the structural benchmarks contained in the program (Table 9). They have verified the existing stock of domestic arrears, paid MK12 billion (17 percent of the total) this fiscal year, and converted about 40 percent of the total into promissory notes redeemable over several years, beginning in FY2013/14. The benchmark regarding use of the Integrated Financial Management Information System (IFMIS) to support commitment control was partially met; a pilot using the purchase order module for day-to-day operating expenses (but not those with longer lead-in times and/or multiple payments dates such as capital projects) was successfully implemented. With respect to the financial sector, the RBM published the second semi-annual financial stability report (covering March–October 2012) in January 2013.

POLICY DISCUSSIONS

14. The medium-term outlook that framed policy discussions has not changed materially since the first review (Text Table). The main features are:

- A rebound in growth from 2013, based on greater availability of foreign exchange and a strong recovery in food and tobacco production.
- Rapid deceleration in inflation from mid-2013 with the onset of the harvest season and reflecting the lagged effect of tightened monetary policy.
- A narrowing of the current account deficit over the medium term, reflecting a marked increase in export earnings.
- Low external debt service burden (estimated to remain below 5 percent over the medium term).

Text Table 4. Malawi: Selected Indicators

	Est.	Program				Revised Program			
	2011	2012	2013	2014	2015	2012	2013	2014	2015
Real GDP growth	4.3	1.9	5.5	6.1	6.5	1.9	5.5	6.1	6.5
CPI inflation (eop)	9.8	31.7	10.1	5.8	5.4	34.6	11.8	5.8	5.4
CPI inflation (average)	7.6	20.8	18.0	7.2	5.7	21.3	20.2	8.1	5.8
Fiscal indicators (% of GDP, fiscal year basis)[1]									
Government domestic revenue (% of GDP)	24.5	22.1	23.3	24.1	24.5	22.1	23.9	24.4	24.8
Grants	7.6	4.4	14.5	12.8	11.3	4.4	15.1	13.0	11.4
Expenditure and net lending	35.0	35.0	39.7	38.9	37.5	34.9	40.2	38.6	37.2
Overall balance including grants	-2.9	-8.5	-1.9	-1.9	-1.6	-8.4	-1.2	-1.3	-1.0
Domestic financing	1.7	6.6	-1.3	0.0	0.0	6.7	-1.6	-0.5	-0.5
External indicators (% of GDP, unless otherwise indicated)									
Current account balance including official transfers	-5.9	-4.3	-1.7	-1.8	-1.6	-4.7	-1.6	-1.8	-2.2
Current account balance excluding official transfers	-12.3	-15.7	-12.7	-12.1	-11.2	-18.8	-17.2	-16.1	-15.4
Overall balance	-1.8	-0.5	3.2	2.9	3.2	0.6	3.5	3.4	3.3
Gross international reserves									
In US$ millions	190.2	204.5	405.7	564.9	728.6	215.4	402.8	555.5	692.8
In month of imports	1.0	1.0	2.0	2.6	3.1	1.1	1.9	2.5	2.9

Source: IMF staff estimates and projections.

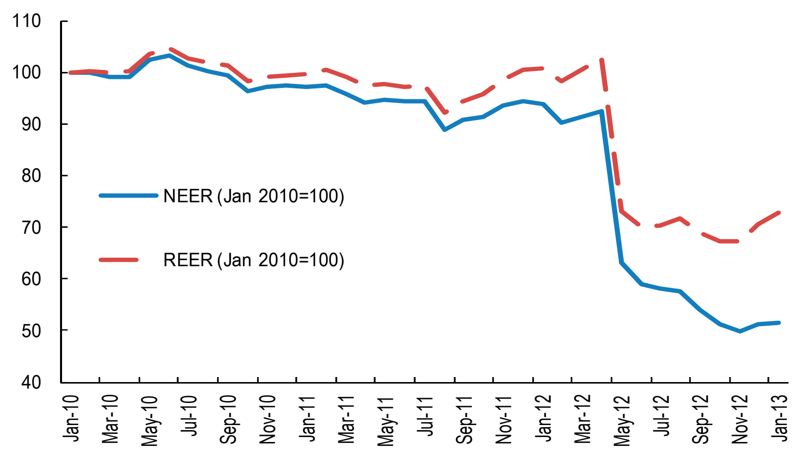
[1] For example, 2011 refers to FY2010/11 (spanning July 1, 2010 through June 30, 2011).

15. **The main macroeconomic policy challenge currently facing the authorities is how to prevent a depreciation-inflation spiral.** The RBM tightened monetary policy in the fourth quarter of 2012 by reducing lending to banks and increasing the policy rate. For the remainder of FY2012/13 (i.e., through end-June 2013), they agreed to lower the ceiling on the RBM's net domestic assets by 5 percent compared to the target set under the first review. The authorities believe the monetary policy stance is currently very tight. They agreed to additional fiscal restraint to contain aggregate demand and boost international reserves. They indicated that they would continue close monitoring of inflation developments, and would tighten policies further if inflation pressures persist (MEFP ¶20).

A. Exchange Rate Policy

16. **The authorities continue to implement a flexible market-based exchange rate regime.** The real depreciation of the kwacha has been sustained at about 30 percent since the May 2012 devaluation (Text Chart). An updated assessment of the real exchange rate indicates that the kwacha was undervalued by about 8 percent as at end-November 2012, possibly reflecting overshooting of the exchange rate (Appendix II).

Text Chart. NEER and REER



Source: IMF staff estimates.

B. Monetary Policy and Financial Sector Issues

17. **The RBM is committed to maintaining a tight monetary policy stance until inflation pressures recede.** [1] The RBM has used open market operations and changes in the policy rate as its main instruments of monetary policy. Increases in the policy rate have quickly translated into increases in other interest rates, especially banks' lending rates which are now positive in real terms (MEFP ¶10). The authorities expressed concern that high lending rates have raised default risks in the banking system and were jeopardizing growth prospects. Staff urged the authorities to give the highest priority to lowering inflation, which may require further tightening of policy to address potential second round effects from the recent increase in civil servants wages and salaries. The authorities indicated that curbing inflation was their top priority and that they are taking steps to strengthen the effectiveness of the RBM's liquidity management framework in guiding monetary operations (MEFP 22). To this end, efforts have been underway to improve the provision of timely

[1] The monetary policy discussions were informed by several quantitative exercises on relationships between money, prices and the exchange rate. For a sample, see Appendix III.

information on government operations to the RBM. The signing of a memorandum of understanding between the Ministry of Finance and the RBM, establishing that the government budget will bear the cost of using treasury bills for monetary operations, is a prior action for completion of this (second) review (Table 9).

18. **The authorities are seeking additional external support to help stabilize the exchange rate.** The authorities indicated that they will be seeking additional external support from development partners, preferably in the form of budget or balance of payments support to help the RBM boost international reserves. Staff recommended that the RBM accumulate international reserves through foreign exchange purchases during the tobacco purchase season, and that this intervention in the market be sterilized to contain inflation.

19. **Financial stability indicators suggest that the banking system remains sound, but there are emerging threats to financial stability.** Indicators for end-December 2012 suggest a low level of non-performing loans (7 percent of outstanding loans) and strong earnings and profitability ratios (average return on assets of 17 percent). However, a widespread practice of loan restructuring makes it difficult to use reported data to accurately assess asset quality. As a result, non-performing loans may be understated. Several banks informed the mission that risks of loan defaults have increased in the current high-interest and weakening kwacha environment. The mission learned that a number of banks continue to have weak liquidity positions and that a few are close to breaching minimum capital requirements.

20. **The RBM is strengthening its oversight of banks (MEFP ¶25).** The RBM indicated that it has taken several measures to intensify its supervision of banks. Specific measures include a directive to external auditors to assess and report on the magnitude of non-performing loans and associated provisions in all banks. The banks are also required to report more frequently on their liquidity conditions and on past due loans. With respect to distressed banks (i.e., banks that have faced severe and persistent liquidity problems), the RBM has dedicated senior examiners to monitor their activities on a daily basis.

21. **The RBM is seeking technical assistance to strengthen the legal framework for bank resolution.** At the request of the RBM, Fund staff have completed a desk review of the legal framework for bank resolution in Malawi and made preliminary recommendations for reforms. A mission is scheduled for the second half of March 2013 to discuss the desk review report and to assist the authorities with drafting legislation.

C. Fiscal Policy

22. **Outlook for the remainder of FY2012/13.** In order to contain aggregate demand pressures and boost international reserves, the authorities agreed to additional fiscal restraint: the government's net repayment to the banking system increases from 1.3 percent of GDP (ECF first review) to 1.6 percent of GDP. A supplementary budget reflecting this understanding was approved by parliament on March 8. Key elements of the revised budget include (MEFP ¶¶28–30):

- Increased nontax domestic revenues (proceeds from sale of fuel donated by Zambia and South Africa, and collection of vehicle license fees introduced in January 2013).
- Additional budget support and dedicated grants from Malawi's development partners.
- Increased allocations to the education sector (funded by increased dedicated grants).
- An increase in the wage bill equivalent to 0.3 percent of GDP, reflecting the recent wage increase awarded to civil servants, with offsetting cuts in other current expenditures.

23. **Impact of the wage increase and measures to restrain government spending.** In February 2013, the government granted wage increases to striking civil servants ranging from 60 percent for the lowest pay grades to 5 percent for the highest grade. This amounts to an increase in the average wage of about 19 percent (Text Table 5). The authorities explained that the award of the wage increases was part of the government's effort to manage political and social pressures associated with the ongoing reforms. They indicated that the impact of the wage increase on the FY2012/13 budget is neutral since the higher wage bill is being funded by identified cuts and savings from other parts of the budget, mainly savings from the Farm Input Subsidy Program (Ministry of Agriculture) and other recurrent expenditures in the Ministry of Education (MEFP ¶30). However, payment of part of the settlement (i.e., pay increases for two months) has been deferred to next year. In response to staff concerns about the likely impact on wages in the rest of the economy, the authorities noted that wages had already gone up in the private and parastatal sectors, and that the award to civil servants was unlikely to lead to further wage increases in other sectors in the short run. Pressures for further wage increases will depend on the extent to which the authorities succeed in stabilizing macroeconomic conditions. The government also indicated that it has tightened enforcement of the expenditure control measures introduced in December, including the curtailment of government funded official travel, reduced spending on government vehicles, and postponement of some capital expenditures (MEFP ¶31).

Text Table 5. Malawi: Average Nominal and Real Wages in the Civil Service

	Jun-11	Jun-12	Jan-13	
			Before wage increase	February wage increase
Average nominal wage	27,830	37,657	41,280	49,294
Average real wage	27,830	**31,359**	26,333	**31,445**
CPI	318	382	499	499
CPI, June 2011=100	100	120	157	157

Sources: Malawian authorities and IMF staff calculations.

24. **Staff has had preliminary discussions with the authorities on the FY2013/14 budget.** The budget needs to reflect several government commitments, including: the cost of conducting tripartite elections scheduled for May 2014 (estimated at US$60 million or about 1½ percent of

GDP), obligations falling due from the conversion of government domestic arrears into promissory notes, deferred wage awards and the full year impact of the recent wage increases, and spending related to the privatization of Air Malawi. The authorities are seeking assistance from development partners to cover at least half of the estimated cost of the elections; they have received some indications of support, but no firm pledges as yet (MEFP ¶32). Staff urged the authorities to consider revenue measures but they indicated that, in view of several changes that have been made in the last few years and the imminent general elections, they preferred to focus on measures to strengthen revenue administration as well as measures to enhance expenditure efficiency and controls. The outcome of the preliminary discussions is reflected in Text Table 6 below and in Tables 2a and 2b. Firm understandings on the FY 2013/14 budget will be reached at the next review.

Text Table 6. Selected Medium-Term Fiscal Indicators

(Percent of GDP)

		First Review			Second Review		
	2011/12	2012/13	2013/14	2014/15	2012/13	2013/14	2014/15
Revenue and Grants	26.5	37.8	36.9	35.8	39.0	37.3	36.2
Domestic Revenue	22.1	23.3	24.1	24.5	23.9	24.4	24.8
Grants	4.4	14.5	12.8	11.3	15.1	13.0	11.4
Current Expenditures	26.9	31.4	30	29.1	32.2	30.0	29.0
Wages and salaries	7.2	7.8	7.8	7.8	8.1	8.6	8.5
Other current expenditures	19.7	23.6	22.2	21.3	24.1	21.4	20.5
Development Expenditures	8.0	8.4	8.8	8.4	8.0	8.7	8.3
Part I (foreign financed)	3.6	5.4	5.6	5.2	5.0	5.5	5.0
Part II (domestically financed)	4.4	3.0	3.2	3.2	3.0	3.2	3.2
Discrepancy	0.0	0.8	0.0	0.0	0.8	0.0	0.0
Overall balance	-8.4	-1.1	-1.9	-1.6	-1.2	-1.3	-1.0
Total Financing	8.4	1.1	1.9	1.6	0.4	1.3	1.0
Foreign financing (net)	1.6	2.4	1.9	1.6	1.9	1.8	1.5
Domestic financing (net)	6.7	-1.3	0.0	0.0	-1.6	-0.5	-0.5
Memorandum Items:							
Domestic balance [1]	-9.2	-11.1	-9.1	-7.8	-11.3	-8.8	-7.4

Source: IMF staff estimates and projections.

[1] Domestic fiscal balance is calculated by subtracting current and domestically financed development expenditures from domestic revenue.

25. **Domestic revenue mobilization is important for medium-term fiscal sustainability.** Malawi's domestic revenue effort (measured in relation to GDP) is high compared to other countries in sub-Saharan Africa, and the main tax rates are in line with those in neighboring countries. However, reducing aid dependency (and associated vulnerability to aid shocks) requires additional revenue effort and there seems to be scope to increase revenue efficiencies in Malawi (Text Tables 7 and 8). The authorities are making progress in their efforts to strengthen revenue administration and broaden the tax base (MEFP ¶33). Specific measures include the introduction of

electronic fiscal devices to enhance VAT collection, and the deployment of computerized cargo scanners to improve customs administration. The authorities have began compiling data on tax expenditures with a view to tightening control over, and eventually reducing, exemptions and waivers.

Text Table 7. Selected Tax Rates in Malawi and its Neighbors

	Income tax [1]	Corporate tax [1]	VAT
Malawi	30	30	16.5
Mozambique	32	32	17
Tanzania	30	30	18
Uganda	30	30	18
Zambia	35	35	16
Zimbabwe	35	25	15

Sources: IMF country teams; SADC country reports.

[1] Top marginal rate.

Text Table 8. Revenue Efficiency of Selected Tax Rates [1]

	Income tax	Corporate tax	VAT
Malawi	0.17	0.09	0.38
Mozambique [2]	0.09	0.08	0.47
Tanzania	0.10	0.06	0.28
Uganda	0.07	0.04	0.35
Zambia	0.17	0.13	0.31
Zimbabwe	0.19	0.18	0.74

Source: IMF staff estimates.

[1] Calculated as the ratio of revenue in percent of GDP (the FY 2012 is used) divided by the respective tax rate.

[2] For Mozambique, as corporate tax revenues were unusually high (6.38 percent of GDP) in FY 2012 , the ratio as of 2011 is used.

26. **The government needs to identify lower priority expenditures that can be cut or postponed to make room for higher priority spending in FY2013/14 and over the medium term.** The authorities are counting on the results of an ongoing public expenditure review (with support from the World Bank and other partners) to provide a basis for better prioritization in key sectors such as Agriculture, Education, Health and Transport. Preliminary indications suggest scope for efficiency gains in the Farm Input Subsidy Program which accounts for about 80 percent of the budget for the Ministry of Agriculture.

27. **The government is implementing a comprehensive public financial management strategy and has taken steps to contain fiscal risks.** The government is making progress in aspects of the PFM strategy being supported by Fund technical assistance, including commitment control to avoid the accumulation of arrears (MEFP ¶34). With respect to fiscal risks, the authorities indicated that most of those arising from contingent liabilities and operational losses of state-owned enterprises have been addressed; the former through the issuance of promissory notes to clear verified arrears, and the later by allowing state enterprises to charge cost-recovery tariffs or prices (MEFP ¶35).

D. Business Climate and International Competitiveness

28. **Malawi ranks behind its neighbors in indicators of the business environment,** such as the Global Competitiveness Indices (GCI) of the World Economic Forum and the World Bank's doing business report. The Malawi Business Climate Surveys (MBCSs) highlight the following among the main obstacles to doing business in Malawi: (i) lack of access to finance; (ii) inadequate

infrastructure (especially electricity); (iii) inefficient government bureaucracy; (iv) policy instability; and (v) inadequate educated and skilled workforce. The Ministry of Industry and Trade has embarked on a program to create a pro-business environment in consultation with stakeholders in the private sector, civil society and public sector. A one-stop-shop has been established to facilitate the setting up of businesses and to inform investors of available incentives. In November 2012, parliament approved the Single License Bill aimed at reducing the number of procedures and time required to start businesses (MEFP ¶37).

29. **Malawi's National Export Strategy (NES) was officially launched in December 2012.** The NES is a prioritised road map for developing Malawi's production base with an orientation toward boosting export competitiveness (see Appendix IV). The strategy emphasizes four areas: (i) export-oriented clusters for diversification; (ii) conducive business environment; (iii) supportive economic institutions to build the production base of the economy; and (iv) development of competencies, skills and knowledge.

PROGRAM ISSUES AND RISKS

30. **The authorities are requesting modifications to performance criteria for end-March 2013 and end-September 2013 (Table 8b).** The modifications are with respect to: (i) the ceiling on the NDA of the RBM; (ii) the ceiling on the central government's net domestic borrowing; and (iii) the floor on the NIR of the RBM. They are in line with the authorities' tightened monetary policy stance, fiscal restraint, and also reflect new information on the expected phasing of aid flow disbursements. New performance criteria and other quantitative criteria for end-March 2014 are proposed.

31. **A prior action and two new structural benchmarks have been added to the program (Table 9).** The prior action relates to the signing of the memorandum of understanding between the RBM and the Ministry of Finance (MOF) establishing that MOF will pay the interest on treasury bills used for monetary operations. In the past, RBM concerns about cost constrained its monetary operations. A new benchmark has been introduced to strengthen public finance management by expanding the use of the commitment control feature of the Integrated Financial Management Information System to cover all procurements by all ministries and departments. A new benchmark has been added to safeguard financial stability: diagnostic assessment of the true financial condition of banks that continue to face liquidity problems.

32. **An update safeguards assessment for the Reserve Bank of Malawi has been completed.** It notes that the RBM continues to publish financial statements that are prepared and audited in accordance with international standards. However, the assessment reiterates a key safeguards concern—the lack of operational autonomy—and recommends that already envisaged amendments to the RBM Act to limit lending to government be expanded to strengthen RBM autonomy more broadly. Other recommendations focus on enhancing oversight of foreign reserves management and improvements to data compilation procedures. The latter includes measures to strengthen transparency of contingent liabilities arising from letters of credit that can have implications for

program data. The RBM is committed to implementing the assessment's recommendations, and has requested technical assistance to strengthen the compilation of monetary and financial statistics.

33. **Risks from global spillovers.** Downside risks to the program include potential spillovers from the global economy, including stagnation of euro area and world growth, a substantial fall in non-oil commodity prices, and a reduction in aid flows. Slower world growth would adversely affect demand for Malawi's exports (mainly tobacco), but the overall impact on Malawi's growth is expected to be low. A substantial fall in tobacco prices would adversely affect export proceeds, the income of farmers and dampen growth. Given the size of tobacco in the economy (15 percent of GDP), the expected impact would be moderate. The risk of lower aid flows remains low. Most of the major donors expect to continue providing assistance to Malawi if the government continues to implement appropriate economic policies and there is no deterioration in human rights and political governance. However, with the EU as one of the major donors, it is conceivable that over the medium term aid to Malawi might decline because of shrinking aid budgets in Europe. Over the medium-to-long term, a reduction in world demand for tobacco (reflecting the impact of a worldwide anti-smoking campaign led by WHO) would also hurt Malawi substantially. Export diversification is a key objective of the government's recently launched National Export Strategy (NES).

34. **Other risks include adverse weather conditions and policy reversals in the lead up to the 2014 general elections.** Adverse weather conditions pose a significant risk because of the continued reliance on rain-fed agriculture. Lower agricultural output would have a significant effect on overall GDP growth given the size of agriculture in GDP (30 percent). Policy reversals would jeopardize the prospects for recovery and sustained growth, and may lead to another cut in aid flows. It is important to avoid loose fiscal and monetary policies in the run-up to the elections in 2014, in order to build credibility for Malawi's commitment to the implementation of prudent policies. Slippages in implementing structural reforms would dampen the country's prospects for long-term growth and reducing vulnerability to shocks.

STAFF APPRAISAL

35. **The authorities remain committed to the policy reforms they have been implementing since May 2012.** While they have made concessions in response to political and social pressures (e.g., the recent wage increase to striking civil servants), the cornerstones of the reforms—market based exchange rate regime and automatic adjustment mechanism for fuel prices—have remained unchanged, and the real effective exchange rate depreciation has been sustained.

36. **Policy continuity is critical for curbing inflation and for a sustained recovery.** Staff welcomes the authorities' commitment to maintain a tight monetary policy stance until inflation pressures recede and to exercise fiscal restraint to curb aggregate demand and help accumulation of international reserves. The authorities should stand ready to tighten policies if signs emerge of second round effects from the recent increase in civil service wages and salaries. Maintaining a

market based exchange rate regime is critical for boosting exports and Malawi's international competitiveness.

37. **The government should re-prioritize spending and consider revenue measures in the FY2013/14 budget.** The budget needs to reflect several government commitments, including the cost of conducting tripartite elections, obligations falling due from the conversion of government domestic arrears into promissory notes, and deferred wage awards and the full year impact of the recent wage increases. Given the high level of inflation and the risk of second round effects from the recent wage increases, a more ambitious fiscal consolidation effort is needed, focused on expenditure control, rather than relying on ad hoc measures. The authorities should identify lower priority items that can be cut or postponed to make room for the outstanding commitments. They should also consider measures to boost domestic revenues, such as reducing exemptions and duty waivers.

38. **The RBM should intensify its oversight of banks and enforce prudential regulation.** Staff welcomes the steps taken by the RBM to strengthen its oversight of the banking system. The RBM should act swiftly on audit reports on the financial condition of banks, including enforcing prudential regulations (especially capital requirements). It should also scrutinize more carefully the reports from banks on their liquidity conditions and past due loans.

39. **Staff recommends completion of the second review, based on satisfactory performance and the authorities' policy commitments.** Staff also recommends approval of the authorities' request for modification of end-March 2013 and end-September 2013 performance criteria.

Table 1. Malawi: Selected Economic Indicators, 2009–16

Population (millions)	**16.20**
Per capita GDP ($US)	**285.00**
Poverty rate (%)	**52.00**

	2009	2010	2011	2012	2012	2013	2013	2014	2015	2016
	Act.	Act.	Act.	Prog.	Prel.	Prog.	Rev. Prog.	Proj.	Proj.	Proj.
National accounts and prices (percent change, unless otherwise indicated)										
GDP at constant market prices	9.0	6.5	4.3	1.9	1.9	5.5	5.5	6.1	6.5	6.7
Nominal GDP (billions of kwacha) [1]	710.2	812.4	880.9	1,062.1	1,056.3	1,298.6	1,310.5	1,492.4	1,675.5	1,868.1
GDP deflator	8.4	7.4	3.9	18.5	17.7	15.9	17.6	7.4	5.4	4.5
Consumer prices (end of period)	7.6	6.3	9.8	31.7	34.6	10.1	11.8	5.8	5.4	4.6
Consumer prices (annual average)	8.4	7.4	7.6	20.8	21.3	18.0	20.2	8.1	5.8	4.9
Investment and savings (percent of GDP)										
National savings	20.7	24.7	9.4	13.8	12.4	19.9	19.1	20.4	20.3	21.1
Net factor income	-1.2	-2.0	-2.1	-3.2	-3.2	-3.9	-3.9	-3.9	-3.8	-3.7
Net official transfers	9.4	15.7	6.4	14.8	14.0	14.4	15.6	14.3	13.3	12.2
Net private transfers	5.1	4.7	4.6	6.2	6.2	7.3	7.2	7.0	6.8	6.7
Domestic savings	7.5	6.3	0.6	-3.9	-4.6	2.1	0.1	3.0	4.1	5.9
Government	-7.1	-0.8	-3.4	-9.8	-7.3	-7.7	-9.2	-4.5	-3.4	-2.8
Private	14.6	7.0	3.9	5.9	2.7	9.8	9.3	7.5	7.5	8.7
National investment	25.6	26.0	15.3	17.4	17.1	21.4	20.6	22.2	22.5	24.1
Government	6.5	9.6	6.7	8.7	8.4	8.1	7.3	8.5	8.2	8.1
Private	19.1	16.4	8.6	8.7	8.7	13.4	13.3	13.8	14.4	16.0
Saving-investment balance [2]	-4.8	-1.3	-5.9	-3.6	-4.7	-1.6	-1.6	-1.8	-2.2	-3.0
Government	-5.0	1.5	-5.4	-6.4	-4.3	-4.1	-3.6	-1.1	-0.6	-1.0
Private	0.1	-2.8	-0.5	2.9	-0.4	2.5	2.0	-0.7	-1.6	-2.0
Central government (percent of GDP on a fiscal year basis) [3]										
Revenue	32.1	33.8	32.1	26.5	26.5	37.8	39.0	37.3	36.2	35.5
Tax and nontax revenue	20.5	23.5	24.5	22.1	22.1	23.3	23.9	24.4	24.8	25.1
Grants	11.6	10.3	7.6	4.4	4.4	14.5	15.1	13.0	11.4	10.5
Expenditure and net lending	37.8	33.8	35.0	35.0	34.9	39.7	40.2	38.6	37.2	36.3
Overall balance (excluding grants)	-17.3	-10.3	-10.5	-13.0	-12.8	-16.5	-16.3	-14.3	-12.5	-11.3
Overall balance	-5.7	0.1	-2.9	-8.5	-8.4	-1.9	-1.2	-1.3	-1.0	-0.8
Foreign financing	2.0	0.9	1.3	1.6	1.6	2.4	1.9	1.8	1.5	1.3
Domestic financing	3.7	-0.9	1.7	6.6	6.7	-1.3	-1.6	-0.5	-0.5	-0.5
Privatization	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discrepancy	-0.1	-0.1	-0.1	0.3	0.1	0.8	0.8	0.0	0.0	0.0
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)										
Money and quasi money	23.9	33.9	35.7	17.1	22.9	26.5	25.9	16.9	17.9	18.2
Net foreign assets	-15.5	13.3	-7.9	-0.6	9.2	13.9	13.4	12.0	11.0	9.5
Net domestic assets	39.5	20.6	43.6	17.7	13.8	12.7	12.5	4.9	6.9	8.7
Credit to the government	19.4	-9.2	19.7	2.3	0.0	6.3	5.8	-1.7	-2.4	-0.3
Credit to the rest of the economy (percent change)	36.5	47.6	30.1	19.7	22.4	9.7	9.9	10.7	16.7	15.9
External sector (US$ millions, unless otherwise indicated)										
Exports (goods and services)	1,050.2	1,360.4	1,408.7	1,357.5	1,359.8	1,603.6	1,573.1	1,718.3	1,849.5	1,988.5
Imports (goods and services)	1,961.1	2,425.4	2,236.2	2,259.6	2,274.9	2,329.6	2,356.0	2,520.7	2,690.7	2,890.9
Usable gross official reserves	140.5	279.6	190.2	214.7	215.4	403.3	402.8	555.5	692.8	797.7
(months of imports)	0.7	1.5	1.0	1.1	1.1	1.9	1.9	2.5	2.9	3.1
(percent of reserve money)	40.7	73.4	42.5	75.0	72.7	117.3	118.7	144.9	156.8	157.5
Current account (percent of GDP)	-4.8	-1.3	-5.9	-3.6	-4.7	-1.6	-1.6	-1.8	-2.2	-3.0
Current account, excl. official transfers (percent of GDP)	-14.2	-17.0	-12.2	-18.3	-18.8	-16.0	-17.2	-16.1	-15.4	-15.3
Real effective exchange rate (percent change)	9.5	-6.0	-3.3	...	...	...	...	...	...	...
Overall balance (percent of GDP)	-2.0	2.2	-1.9	-0.1	0.6	3.7	3.5	3.4	3.3	2.8
Terms of trade (percent change)	7.7	1.9	-17.1	-3.3	-2.4	1.5	2.5	3.0	2.7	2.2
Debt stock and service (percent of GDP, unless otherwise indicated)										
External debt (public sector)	15.9	16.0	16.2	22.7	22.8	26.6	26.2	24.3	22.6	21.1
NPV of debt (percent of exports)	57.1	44.6	48.1	53.3	53.2	46.1	47.0	42.2	38.2	34.4
External debt service (percent of exports)	1.3	1.3	1.6	2.4	2.4	2.5	2.6	3.8	3.9	3.7
External debt service (percent of revenue excl. grants)	1.4	1.5	1.7	3.9	3.9	5.1	5.0	6.9	6.7	6.2
91-day treasury bill rate (end of period)	10.5	6.2	6.8	...	20.1	...	...	...	...	...

Sources: Malawian authorities and IMF staff estimates.

[1] Reflects substantial upward revisions to the historical national accounts data received in March 2011.

[2] The government savings—investment balance is calculated adding foreign grants to government savings above.
The private savings—investment balance is calculated adding the items in the balance of payments, net of foreign grants, to private savings above.

[3] For example, 2009 refers to fiscal year 2008/09, which is from July 1, 2008, to June 30, 2009.

Table 2a. Malawi: Central Government Operations, 2009/10–2015/16

(Billions of kwacha)

	2009/10	2010/11	2011/12		2012/13		2013/14	2014/15	2015/16
	Actual	Actual	Prog.	Prel.	Prog.	Rev. Prog.	Proj.	Proj.	Proj.
Revenue	257	272	260	257	446	461	523	573	630
Tax and nontax revenue	179	208	208	214	275	282	341	392	444
Tax revenue	142	176	181	188	242	244	303	348	395
Taxes on income and profits	66	81	90	90	114	114	135	155	176
Taxes on goods and services	64	79	80	84	106	105	135	158	179
Taxes on international trade	15	17	18	18	30	30	40	44	50
Other	-4	-2	-6	-3	-7	-6	-7	-8	-9
Nontax revenue	37	32	27	26	33	39	39	44	49
Grants	78	64	53	43	171	179	182	181	186
Budget support	34	15	0	0	73	77	70	67	69
Project	26	19	17	18	35	35	42	44	45
Dedicated grants	19	31	35	25	64	67	70	70	72
Of which:			0						
DFID/EU (maize, fertilizer and seed)	4	3	7	9	16	14	10	8	8
National AIDS Commission	7	10	9	4	13	13	19	19	20
Health Sector–Wide Approach (SWAp)	8	11	10	4	12	12	14	14	15
Education Sector–Wide Approach (SWAp)		0			19	25	21	22	22
Road Sector Support		0			4	4	6	7	7
Expenditure and net lending	257	296	328	338	469	476	541	590	644
Current expenditure	196	230	251	261	370	381	420	459	505
Wages and salaries	45	58	70	70	92	96	120	135	151
Interest payments	21	23	20	24	33	33	32	28	27
Domestic	21	22	19	22	29	29	28	23	20
Foreign	1	1	2	2	4	4	5	5	6
Goods and services	84	95	103	95	138	143	153	169	187
Generic goods and services	44	41	60	53	61	56	57	60	66
Census	0	0	0	0	0	0	0	0	0
Roads	8	8	6	7	10	10	8	9	11
Health SWAp	20	19	16	16	23	24	29	33	37
Education SWAp	0	10	11	9	20	26	34	38	43
Statutory expenditures	2	3	4	4	5	6	7	8	9
National AIDS Commission	8	12	5	5	13	13	16	18	21
Maize purchases	2	2	1	1	5	5	1	1	2
Rural electrification program						3			
Subsidies and other current transfers	45	54	58	57	98	98	103	117	131
Pension and gratuities	6	12	12	10	16	16	19	21	24
Transfers to road and revenue authorities	4	5	4	5	8	7	9	10	12
Transfers to public entities	13	15	17	17	19	22	26	30	33
Fertilizer and seed subsidy	22	22	25	24	55	53	49	56	62
Arrears payments	0	0	0	15	10	12	11	10	9
Development expenditures	60	65	77	78	99	94	121	131	139
Part I (foreign financed)	34	32	35	35	63	59	77	80	82
Part II (domestically financed)	26	33	42	42	36	35	44	51	57
Net lending	1	1	0	0	0	0	0	0	0
Overall balance (including grants)	0	-24	-68	-81	-23	-14	-18	-16	-14
Discrepancy [1]	0	0	0	0	10	10	0	0	0
Overall balance (including grants and discrepancy)	0	-24	-68	-81	-13	-4	-18	-16	-14
Total financing (net)	0	24	68	81	13	4	18	16	14
Foreign financing (net)	7	11	16	16	28	23	26	24	23
Borrowing	8	13	18	18	34	29	35	36	37
Program	0	0	0	1	5	5	0	0	0
Project	8	13	18	17	29	24	35	36	37
Other concessional	0	0	0	0	0	0	0	0	0
Amortization	-2	-2	-3	-3	-6	-6	-9	-12	-14
Domestic financing (net)	-7	14	54	65	-15	-19	-7	-8	-9
Privatization	0	0	0	0	0	0	0	0	0
Memorandum items:									
Domestic balance [2]	-43	-56	-85	-89	-131	-134	-123	-118	-118
Nominal GDP	761	847	964	969	1,180	1,183	1,401	1,584	1,772
Net domestic debt [3]	110	138	192	188	170	197	197	197	197
Net domestic debt in precent of GDP	14	16	20	20	14	17	14	12	11

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] The discrepancy includes a carry-over of revenues from FY2011/12 which was used in 2012/13 to retire unbudgeted borrowing in the last quarter of FY2012/13.

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

[3] In FY 2012/13, the revised program numbers include the MK 30 biln of promissory notes issued by the government to settle the arrears.

Table 2b. Malawi: Central Government Operations, 2009/10–2015/16

(Percent of GDP)

	2009/10	2010/11	2011/12		2012/13		2013/14	2014/15	2015/16
	Actual	Actual	Prog.	Prel.	Prog.	Rev. Prog.	Proj.	Proj.	Proj.
Revenue	33.8	32.1	27.0	26.5	37.8	39.0	37.3	36.2	35.5
Tax and nontax revenue	23.5	24.5	21.5	22.1	23.3	23.9	24.4	24.8	25.1
Tax revenue	18.6	20.8	18.8	19.4	20.5	20.6	21.6	22.0	22.3
Taxes on income and profits	8.7	9.6	9.3	9.2	9.6	9.6	9.6	9.8	9.9
Taxes on goods and services	8.5	9.4	8.3	8.7	8.9	8.9	9.6	10.0	10.1
Taxes on international trade	2.0	2.1	1.8	1.9	2.5	2.6	2.8	2.8	2.8
Other	-0.5	-0.3	-0.7	-0.3	-0.6	-0.5	-0.5	-0.5	-0.5
Nontax revenue	4.9	3.8	2.8	2.7	2.8	3.3	2.8	2.8	2.8
Grants	10.3	7.6	5.5	4.4	14.5	15.1	13.0	11.4	10.5
Budget support	4.5	1.8	0.0	0.0	6.1	6.5	5.0	4.3	3.9
Project	3.4	2.2	1.8	1.9	2.9	3.0	3.0	2.7	2.5
Dedicated grants	2.4	3.6	3.6	2.6	5.4	5.7	5.0	4.4	4.1
Of which:									
DFID/EU (maize, fertilizer and seed)	0.5	0.3	0.7	0.9	1.4	1.2	0.7	0.5	0.5
National AIDS Commission	0.9	1.1	0.9	0.4	1.1	1.1	1.3	1.2	1.1
Health Sector–Wide Approach (SWAp)	1.1	1.3	1.1	0.4	1.0	1.0	1.0	0.9	0.8
Education Sector–Wide Approach (SWAp)					1.6	2.1	1.5	1.4	1.3
Road Sector Support					0.4	0.4	0.4	0.4	0.4
Expenditure and net lending	33.8	35.0	34.0	34.9	39.7	40.2	38.6	37.2	36.3
Current expenditure	25.7	27.2	26.0	26.9	31.4	32.2	30.0	29.0	28.5
Wages and salaries	5.9	6.9	7.2	7.2	7.8	8.1	8.6	8.5	8.5
Interest payments	2.8	2.7	2.1	2.5	2.8	2.8	2.3	1.8	1.5
Domestic	2.7	2.6	1.9	2.2	2.5	2.4	2.0	1.4	1.1
Foreign	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Goods and services	11.0	11.2	10.7	9.8	11.7	12.0	10.9	10.7	10.6
Generic goods and services	5.8	4.8	6.3	5.5	5.2	4.7	4.1	3.8	3.7
Census	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Roads	1.0	0.9	0.7	0.7	0.8	0.8	0.6	0.6	0.6
Health SWAp	2.6	2.2	1.6	1.7	2.0	2.1	2.1	2.1	2.1
Education SWAp	0.0	1.2	1.1	0.9	1.7	2.2	2.4	2.4	2.4
Statutory expenditures	0.2	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5
National AIDS Commission	1.0	1.5	0.5	0.5	1.1	1.1	1.1	1.2	1.2
Maize purchases	0.3	0.2	0.1	0.1	0.4	0.4	0.1	0.1	0.1
Rural electrification program	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0
Subsidies and other current transfers	6.0	6.4	6.0	5.9	8.3	8.3	7.4	7.4	7.4
Pension and gratuities	0.8	1.4	1.2	1.1	1.3	1.3	1.3	1.3	1.3
Transfers to road and revenue authorities	0.6	0.6	0.5	0.6	0.7	0.6	0.6	0.7	0.7
Transfers to public entities	1.7	1.7	1.7	1.8	1.6	1.9	1.9	1.9	1.9
Fertilizer and seed subsidy	2.9	2.6	2.6	2.5	4.7	4.4	3.5	3.5	3.5
Arrears payments	0.0	0.0	0.0	1.5	0.8	1.0	0.8	0.6	0.5
Development expenditure	7.9	7.7	8.0	8.0	8.4	8.0	8.7	8.3	7.8
Part I (foreign financed)	4.5	3.7	3.7	3.6	5.4	5.0	5.5	5.0	4.6
Part II (domestically financed)	3.4	3.9	4.4	4.4	3.0	3.0	3.2	3.2	3.2
Net lending	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	0.1	-2.9	-7.0	-8.4	-1.9	-1.2	-1.3	-1.0	-0.8
Discrepancy [1]	-0.1	0.0	0.0	0.0	0.8	0.8	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	0.0	-2.9	-3.0	-8.4	-1.1	-0.4	-1.3	-1.0	-0.8
Total financing (net)	-0.1	2.9	7.0	8.4	1.1	0.4	1.3	1.0	0.8
Foreign financing (net)	0.9	1.3	1.6	1.6	2.4	1.9	1.8	1.5	1.3
Borrowing	1.1	1.5	1.9	1.9	2.9	2.5	2.5	2.3	2.1
Program	0.0	0.0	0.0	0.1	0.4	0.4	0.0	0.0	0.0
Project	1.1	1.5	1.9	1.8	2.4	2.0	2.5	2.3	2.1
Other concessional	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.2	-0.2	-0.3	-0.3	-0.5	-0.5	-0.7	-0.8	-0.8
Domestic financing (net)	-0.9	1.7	5.6	6.7	-1.3	-1.6	-0.5	-0.5	-0.5
Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Domestic balance [2]	-5.6	-6.6	-8.8	-9.2	-11.1	-11.3	-8.8	-7.4	-6.7
Nominal GDP	761	847	964	969	1,180	1,183	1,401	1,584	1,772
Net domestic debt	110	138	192	188.0	170	197	197	170	163
Net domestic debt, percent of GDP	14	16	20	20	14	17	14	11	9

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] The discrepancy includes a carry-over of revenues from FY2011/12 which was used in 2012/13 to retire unbudgeted borrowing in the last quarter of FY2012/13.

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

[3] In FY 2012/13, the revised program numbers include the MK 30 biln of promissory notes issued by the government to settle the arrears.

Table 2c. Malawi: Central Government Operations, 2012/2013
(Billions of kwacha)

	Q1 Act.	Q1 Prog.	Q2 Act.	Q2 Prog.	Q3 Proj.	Q4 Proj.	2012/13 Proj.
Revenue	116	122	122	120	101	123	461
Tax and nontax revenue	64	73	72	69	66	80	282
Tax revenue	58	63	63	61	55	68	244
Taxes on income and profits	26	24	28	27	27	34	114
Taxes on goods and services	26	28	27	28	24	28	105
Taxes on international trade	7	13	8	8	6	8	30
Other	-1	-2	-1	-2	-2	-2	-6
Pension contributions	0	0	0	0	0	0	0
Nontax revenue	6	11	9	8	11	12	39
Of which: maize sales receipts	0	0	0	0	0	0	0
Grants	52	48	50	51	34	43	179
Budget support	24	22	30	26	2	20	77
Project	11	6	7	6	9	9	35
Dedicated grants	17	21	13	19	24	14	67
Of which:							
DFID/EU (maize, fertilizer and seed)	0	2	8	8	3	3	14
National AIDS Commission	1	5	0	4	7	5	13
Health Sector–Wide Approach (SWAp)	8	5	1	0	3	0	12
Education (SWAp)	3	3	4	7	11	7	25
Roads	4	4	0	0	0	0	4
Expenditure and net lending	105	115	137	142	119	114	476
Current expenditure	80	90	111	117	96	94	381
Wages and salaries	21	20	24	24	24	28	96
Of which: health SWAp	3	0	3	3	1	1	98
Interest payments	8	9	3	8	9	13	33
Domestic	7	9	2	8	8	12	29
Foreign	1	0	1	1	1	1	4
Goods and services	33	33	34	35	36	38	143
Generic goods and services	16	10	17	14	10	12	56
Census	0	0	0	0	0	0	0
Roads	2	4	2	3	3	3	10
Health SWAp	5	9	6	6	6	7	24
Education SWAp	4	4	4	5	9	8	26
National / local elections	0	0	0	0	0	0	0
Statutory expenditures	1	1	2	1	1	2	6
National AIDS Commission	2	3	1	6	4	5	13
Maize purchases	1	1	0	0	2	1	5
Rural Electrification Program	1	0	2	0	0	0	3
Subsidies and other current transfers	12	25	45	46	27	14	98
Pension and gratuities	4	5	4	4	4	4	16
Transfers to road and revenue authorities	2	2	2	2	1	2	7
Transfers to public entities	5	4	5	6	6	5	22
Transfers to local governments	5	0	5	6	6	5	55
Fertilizer and seed subsidy	0	13	33	35	15	4	53
Arrears payments	7	3	5	3	0	0	12
Development expenditure	25	25	27	26	23	20	94
Part I (foreign financed)	13	9	15	15	15	16	59
Part II (domestically financed)	11	15	12	11	7	5	35
Overall balance (excluding grants)							
Overall balance (including grants)	11	7	-16	-22	-19	9	-14
Discrepancy	29	0	-13	-10	-5	-1	10
Overall balance (including grants and discrepancy)	40	7	-29	-32	-24	8	-4
Total financing (net)	-40	-7	29	32	24	-8	4
Foreign financing (net)	2	5	5	9	9	7	23
Borrowing	3	6	7	10	10	9	29
Program	0	2	0	2	3	2	5
Project	3	4	7	9	7	7	24
Other concessional	0	0	0	0	0	0	0
Amortization	0	-1	-2	-2	-1	-2	-6
Domestic financing (net)	-42	-12	24	23	15	-15	-19
Privatization							

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] The discrepancy includes a carry-over of revenues from FY2011/12, which was used in 2012/13 to retire unbudgeted borrowing in the last quarter of FY2011/12.

Table 3a. Malawi: Monetary Authorities' Survey, 2009–16

(Billions of kwacha, unless otherwise indicated)

	2009	2010	2011	2012					2013								2014		2015	2016
				Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q4		
	Act.			Act.			Prog.	Act.	Prog.				Rev. Prog.				Prog.	Proj.	Proj.	
Reserve money	50	57	73	88	101	91	97	99	99	108	112	122	98	107	110	119	116	139	164	194
Currency outside banks	27	31	42	37	62	54	...	55	...	...	...	...	...	...	...	...	...	...	...	...
Cash in vault	6	9	11	9	12	12	...	16	...	...	...	...	...	...	...	...	...	...	...	...
Commercial bank deposits with RBM	17	18	20	42	27	25	...	28	...	...	...	...	...	...	...	...	...	...	...	...
Net foreign assets (NFA) [1]	-9	8	-9	-18	-43	-25	-23	-20	-35	-7	19	26	-29	-2	24	27	23	80	137	193
Foreign assets [2]	24	46	32	24	23	54	74	73	68	103	130	144	72	107	133	142	137	203	258	306
Foreign liabilities	-34	-37	-40	-41	-66	-80	-96	-93	-103	-111	-111	-118	-101	-108	-109	-116	-107	-116	-122	-113
Net domestic assets	60	49	82	105	144	116	119	119	134	115	92	96	127	109	86	92	93	60	27	454
Credit to government (net) 3	86	73	103	125	136	92	109	110	125	111	107	127	121	110	106	128	125	121	111	105
Credit to statutory bodies (net)	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to domestic banks	0	0	0	3	20	12	4	0	4	4	4	4	0	0	0	0	0	0	0	0
Other items (net)[3]	-27	-24	-21	-22	-13	12	7	9	6	0	-19	-35	6	-2	-20	-36	-32	-62	-84	-104
Open market operations	-8	-16	-9	-7	-5	-6		-14					-17	-25	-44	-59	-55	-83	-103	-123
Others	-19	-8	-11	-15	-7	18		23					23	24	23	23	23	21	19	14
Memorandum items:																				
Money multiplier	3.4	4.0	4.3	3.6	3.5	3.9	3.8	3.9	3.8	3.8	3.8	3.8	3.9	3.9	4.0	4.1	4.1	4.1	4.1	4.1
91-day treasury bill rate	10.5	6.2	6.8	7.1	15.6	18.7	...	20.1	...	...	...	...	...	...	...	...	...	...	...	...
NFA (US$ millions)	-65	54	-54	-107	-158	-85	-68	-60	-103	-21	55	73	-85	-5	69	76	66	219	368	505
Foreign assets (US$ millions)	167	302	193	141	86	182	218	219	200	299	372	406	214	312	383	406	388	559	696	801
Foreign liabilities (US$ millions)	-231	-248	-247	-248	-244	-267	-285	-278	-303	-320	-317	-334	-299	-317	-314	-330	-322	-340	-328	-296

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

[1] Including SDR allocation and the entire assets and liabilities of the RBM

[2] Reserve holdings managed by the Crown Agents have not yet been verified by an independent audit agency. These assets amounted to US$3.2 million at end-December, 2012.

[3] Includes recapitalization of RBM with a transfer of treasury bills in the amount of 29.3 billion in January 2008.

Table 3b. Malawi: Monetary Survey, 2009–16

(Billions of Kwacha, unless otherwise indicated)

				2012					2013								2014			
	2009	2010	2011	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q4	2015	2016
		Act.			Act.		Prog.	Prel.		Prog.				Rev. Prog.			Prog.	Proj.	Proj.	Proj.
Money and quasi-money	173	232	314	316	357	350	368	386	379	410	428	466	388	416	439	487	475	569	671	792
Money	82	125	164	156	221	199	…	222	…	…	…	…	…	…	…	…	…	…	…	…
Quasi-money	91	107	150	160	135	151	…	164	…	…	…	…	…	…	…	…	…	…	…	…
Of which: foreign currency deposits	18	21	26	27	60	56	…	72	…	…	…	…	…	…	…	…	…	…	…	…
Net foreign assets (NFA) [1]	-2	21	3	-4	-4	10	1	31	-11	18	45	52	24	52	79	83	81	142	204	268
Monetary authorities	-9	8	-9	-18	-43	-25	-23	-20	-35	-7	19	26	-29	-2	24	27	23	80	137	193
Gross foreign assets	24	46	32	24	23	54	74	73	68	103	130	144	72	107	133	142	137	203	258	306
Foreign liabilities	-34	-37	-40	-41	-66	-80	-96	-93	-103	-111	-111	-118	-101	-108	-109	-116	-114	-123	-122	-113
Commercial banks (net)	7	13	11	14	39	36	24	51	24	25	25	26	53	54	55	57	58	62	64	75
Net domestic assets	175	211	312	320	360	340	367	355	390	392	384	414	364	364	360	403	394	427	466	525
Credit to government (net)	111	95	141	157	169	127	148	141	168	150	146	171	154	140	136	163	159	155	141	139
Credit to statutory bodies (net)	6	5	20	18	17	18	18	19	18	18	18	18	19	19	19	19	19	19	19	19
Credit to private sector	95	145	175	179	208	209	215	219	217	237	233	237	215	227	227	243	236	271	319	373
Other items (net)	-37	-34	-24	-34	-34	-14	-13	-24	-13	-13	-13	-12	-23	-23	-22	-19	-21	-18	-14	-7
Memorandum items:																				
Velocity of money (annualized GDP divided by broad money)	4.0	3.5	2.8	2.9	2.7	2.9	2.9	2.7	3.0	2.9	2.9	2.8	2.9	2.8	2.8	2.7	2.9	2.6	2.5	2.4
Annual growth of broad money (percent)	23.9	33.9	35.7	34.3	34.3	19.9	17.1	22.9	19.8	14.9	22.3	26.5	22.8	16.6	25.3	25.9	22.4	16.9	17.9	18.2
Annual growth of credit to the private sector (percent)	39.5	52.4	20.5	17.7	27.8	26.6	23.0	25.4	21.3	14.0	11.3	10.6	19.9	9.2	8.5	10.8	9.9	11.6	17.9	16.8
NFA of the commercial banks (US$ millions)	50.7	81.6	68.5	83.3	144.0	119.7	69.8	153.3	70.8	71.7	72.7	73.7	155.4	157.5	159.6	161.7	164.1	171.5	182.7	195.0
Gross foreign assets (US$ millions)	77.9	92.0	103.9	113.6	172.3	139.9	139.9	199.5	141.8	143.7	145.7	147.6	202.3	205.0	207.7	210.5	213.7	223.2	237.8	253.9
Foreign liabilities (US$ millions)	-27.2	-10.5	-35.4	-30.3	-28.2	-20.2	-70.1	-46.3	-71.0	-72.0	-72.9	-73.9	-46.9	-47.5	-48.2	-48.8	-49.6	-51.8	-55.2	-58.9
Foreign currency deposits(US$ millions)	124.6	142.1	160.9	159.6	221.4	189.1		216.1												

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

[1] Including SDR allocation.

Table 4a. Malawi: Balance of Payment, 2009–16

(US$ millions, unless otherwise indicated)

	2009 Act.	2010 Act.	2011 Prel.	2012 Prog.	2012 Prel.	2013 Prog.	2013 Rev.Prog.	2014 Proj.	2015 Proj.	2016 Proj.
Current account balance (including grants)	-244.1	-69.9	-330.0	-150.5	-198.8	-58.9	-60.7	-74.2	-100.1	-149.7
Merchandise trade balance	-636.7	-743.7	-630.1	-658.2	-669.3	-490.1	-533.9	-535.7	-556.4	-596.1
Exports	936.7	1,237.7	1,262.7	1,253.7	1,256.1	1,479.2	1,458.6	1,596.9	1,720.2	1,850.5
Of which: Tobacco	501.3	687.6	482.4	481.1	481.0	606.2	606.1	636.4	668.2	701.6
Uranium	8.5	113.4	120.4	154.4	154.4	169.9	169.9	186.8	205.5	226.1
Imports	-1,573.3	-1,981.3	-1,892.7	-1,911.9	-1,925.3	-1,969.3	-1,992.5	-2,132.6	-2,276.5	-2,446.6
Of which: Petroleum	-166.4	-180.9	-168.8	-169.4	-173.7	-164.7	-174.5	-172.5	-171.3	-171.8
Services balance	-333.2	-429.8	-312.8	-378.4	-380.5	-383.3	-396.5	-429.7	-459.2	-492.0
Interest public sector (net)	-4.7	-3.5	-5.6	-9.6	-10.0	-12.0	-12.0	-14.5	-16.2	-17.8
Receipts	0.4	0.1	0.4	0.8	0.7	0.7	0.3	0.3	0.3	0.0
Payments	-5.1	-3.6	-6.0	-10.4	-10.6	-12.7	-12.3	-14.8	-16.5	-18.1
Other factor payments (net)	-54.2	-105.0	-109.7	-124.8	-124.8	-135.5	-135.5	-148.5	-158.1	-167.5
Nonfactor (net)	-274.3	-321.4	-197.5	-244.0	-245.8	-235.8	-249.0	-266.8	-284.8	-306.3
Receipts	113.5	122.7	146.0	103.8	103.8	124.4	114.4	121.4	129.3	138.0
Payments	-387.8	-444.1	-343.5	-347.7	-349.6	-360.3	-363.5	-388.1	-414.1	-444.3
Unrequited transfers (net)	725.8	1,103.6	612.9	886.0	851.0	814.5	869.7	891.2	915.4	938.3
Private (net)	254.5	254.1	256.0	260.8	259.8	275.1	275.1	291.8	310.9	331.9
Receipts	267.7	267.7	270.8	275.9	274.9	291.1	291.1	308.7	328.9	351.1
Payments	-13.2	-13.6	-14.8	-15.1	-15.1	-15.9	-15.9	-16.9	-18.0	-19.2
Official (net)	471.2	849.5	356.9	625.2	591.2	539.3	594.5	599.4	604.5	606.4
Receipts	472.0	850.2	357.7	625.9	592.0	540.1	595.3	600.2	605.3	607.3
Budget support	81.6	321.7	0.0	171.5	181.5	162.6	164.9	180.7	185.9	185.9
Project related[1]	390.4	528.6	357.6	454.4	410.5	377.5	430.4	419.5	419.5	421.4
Payments	-0.8	-0.7	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Financial account balance	235.0	280.3	157.4	145.7	224.0	199.3	196.0	217.5	249.3	286.9
Medium- and long-term flows (net)	151.3	90.5	108.9	81.8	76.7	89.4	81.5	70.2	66.6	66.6
Disbursements	73.4	104.4	123.3	100.3	94.1	112.7	105.9	100.0	100.0	100.0
Budget support	29.5	0.0	0.0	5.0	0.0	10.0	15.0	0.0	0.0	0.0
Project support	21.9	104.4	53.3	77.9	76.7	102.7	90.9	100.0	100.0	100.0
Other medium-term loans	22.0	0.0	70.0	17.4	17.4	0.0	0.0	0.0	0.0	0.0
Amortization	-8.5	-14.0	-14.4	-18.5	-17.4	-23.3	-24.4	-29.8	-33.4	-33.4
SDR allocation	86.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment and other inflows	55.5	158.2	60.8	61.9	61.9	105.3	105.3	136.7	170.6	207.1
Short-term capital	0.7	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.9	0.9
Commercial banks net foreign assets	27.5	30.9	-13.0	1.3	84.7	3.8	8.4	9.8	11.2	12.3
Errors and omissions	-91.8	-90.3	65.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-100.9	120.1	-106.9	-4.8	25.3	140.4	135.2	143.4	149.1	137.2
Financing	100.9	-120.1	106.9	4.8	-25.3	-140.4	-135.2	-143.4	-149.1	-137.2
Gross reserves (- increase)	98.5	-139.1	107.7	-32.1	-55.0	-188.7	-187.4	-152.7	-137.3	-105.0
Liabilities[2]	2.2	19.1	-1.2	36.9	37.9	48.3	52.2	9.3	-11.9	-32.2
Of which: IMF (net)	-0.4	21.2	-0.1	36.6	37.0	51.9	51.8	14.1	-7.1	-27.9
Purchases/drawings	0.0	21.3	0.0	40.2	40.2	60.2	60.2	40.2	20.1	0.0
Repurchases/repayments	0.4	0.2	0.1	3.6	3.2	8.4	8.5	26.1	27.2	27.9
Memorandum items:										
Gross official reserves[3]	140.5	279.6	190.2	214.7	215.4	403.3	402.8	555.5	692.8	797.7
Months of imports[4]	0.7	1.5	1.0	1.1	1.1	1.9	1.9	2.5	2.9	3.1
Current account balance (percent of GDP)										
Excluding official transfers	-14.2	-17.0	-12.2	-18.3	-18.8	-16.0	-17.2	-16.1	-15.4	-15.3
Including official transfers	-4.8	-1.3	-5.9	-3.6	-4.7	-1.6	-1.6	-1.8	-2.2	-3.0
Value of exports of goods and services (percent change)	0.7	29.5	3.6	-3.6	-3.5	18.1	15.7	9.2	7.6	7.5
Value of imports of goods and services (percent change)	-6.2	23.7	-7.8	1.0	1.7	3.1	3.6	7.0	6.7	7.4
REER (percent change)	9.5	-6.0	-3.3	…	…	…	…	…	…	…
Overall balance (percent of GDP)	-2.0	2.2	-1.9	-0.1	0.6	3.7	3.5	3.4	3.3	2.8
Terms of trade (percent change)	7.7	1.9	-17.1	-3.3	-2.4	1.5	2.5	3.0	2.7	2.2
Nominal GDP (millions of U.S. dollars)	5,034.1	5,396.9	5,613.5	4,236.3	4,212.4	3,750.6	3,816.1	4,178.1	4,561.0	4,951.9

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

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

2 Excluding SDR allocation.

3 Figures for 2009 onward take account of Malawi's SDR allocation (SDR 55.4 million). Gross reserves are measured only from the balance sheet of the central bank and exclude holdings of the government overseas in the crown agent accounts, which was US$ 3.1 million at end-December 2010.

4 Months of prospective imports of goods and nonfactor services.

Table 4b. Malawi: Balance of Payments, 2009–16

(Percent of GDP)

	2009 Act.	2010 Act.	2011 Prel.	2012 Prog.	2012 Prel.	2013 Prog.	2013 Rev. Prog.	2014 Proj.	2015 Proj.	2016 Proj.
Current account balance (including grants)	-4.8	-1.3	-5.9	-3.6	-4.7	-1.6	-1.6	-1.8	-2.2	-3.0
Merchandise trade balance	-12.6	-13.8	-11.2	-15.5	-15.9	-13.1	-14.0	-12.8	-12.2	-12.0
Exports	18.6	22.9	22.5	29.6	29.8	39.4	38.2	38.2	37.7	37.4
Of which: Tobacco	10.0	12.7	8.6	11.4	11.4	16.2	15.9	15.2	14.7	14.2
Uranium	0.2	2.1	2.1	3.6	3.7	4.5	4.5	4.5	4.5	4.6
Imports	-31.3	-36.7	-33.7	-45.1	-45.7	-52.5	-52.2	-51.0	-49.9	-49.4
Of which: Petroleum	-3.3	-3.4	-3.0	-4.0	-4.1	-4.4	-4.6	-4.1	-3.8	-3.5
Services balance	-6.6	-8.0	-5.6	-8.9	-9.0	-10.2	-10.4	-10.3	-10.1	-9.9
Interest public sector (net)	-0.1	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3	-0.3	-0.4	-0.4
Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments	-0.1	-0.1	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4
Other factor payments (net)	-1.1	-1.9	-2.0	-2.9	-3.0	-3.6	-3.5	-3.6	-3.5	-3.4
Nonfactor (net)	-5.4	-6.0	-3.5	-5.8	-5.8	-6.3	-6.5	-6.4	-6.2	-6.2
Receipts	2.3	2.3	2.6	2.4	2.5	3.3	3.0	2.9	2.8	2.8
Payments	-7.7	-8.2	-6.1	-8.2	-8.3	-9.6	-9.5	-9.3	-9.1	-9.0
Unrequited transfers (net)	14.4	20.4	10.9	20.9	20.2	21.7	22.8	21.3	20.1	18.9
Private (net)	5.1	4.7	4.6	6.2	6.2	7.3	7.2	7.0	6.8	6.7
Receipts	5.3	5.0	4.8	6.5	6.5	7.8	7.6	7.4	7.2	7.1
Payments	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Official (net)	9.4	15.7	6.4	14.8	14.0	14.4	15.6	14.3	13.3	12.2
Receipts	9.4	15.8	6.4	14.8	14.1	14.4	15.6	14.4	13.3	12.3
Budget support	1.6	6.0	0.0	4.0	4.3	4.3	4.3	4.3	4.1	3.8
Project related[1]	7.8	9.8	6.4	10.7	9.7	10.1	11.3	10.0	9.2	8.5
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	4.7	5.2	2.8	3.4	5.3	5.3	5.1	5.2	5.5	5.8
Medium- and long-term flows (net)	3.0	1.7	1.9	1.9	1.8	2.4	2.1	1.7	1.5	1.3
Disbursements	1.5	1.9	2.2	2.4	2.2	3.0	2.8	2.4	2.2	2.0
Budget support	0.6	0.0	0.0	0.1	0.0	0.3	0.4	0.0	0.0	0.0
Project support	0.4	1.9	0.9	1.8	1.8	2.7	2.4	2.4	2.2	2.0
Other medium-term loans	0.4	0.0	1.2	0.4	0.4	0.0	0.0	0.0	0.0	0.0
Amortization	-0.2	-0.3	-0.3	-0.4	-0.4	-0.6	-0.6	-0.7	-0.7	-0.7
SDR allocation	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment and other inflows	1.1	2.9	1.1	1.5	1.5	2.8	2.8	3.3	3.7	4.2
Short-term capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks net foreign assets	0.5	0.6	-0.2	0.0	2.0	0.1	0.2	0.2	0.2	0.2
Errors and omissions	-1.8	-1.7	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.0	2.2	-1.9	-0.1	0.6	3.7	3.5	3.4	3.3	2.8
Financing	2.0	-2.2	1.9	0.1	-0.6	-3.7	-3.5	-3.4	-3.3	-2.8
Gross reserves (- increase)	2.0	-2.6	1.9	-0.8	-1.3	-5.0	-4.9	-3.7	-3.0	-2.1
Liabilities[2]	0.0	0.4	0.0	0.9	0.9	1.3	1.4	0.2	-0.3	-0.7
Of which: IMF (net)	0.0	0.4	0.0	0.9	0.9	1.4	1.4	0.3	-0.2	-0.6
Purchases/drawings	0.0	0.4	0.0	0.9	1.0	1.6	1.6	1.0	0.4	0.0
Repurchases/repayments	0.0	0.0	0.0	0.1	0.1	0.2	0.2	0.6	0.6	0.6
Memorandum items:										
Gross official reserves[3]	2.8	5.2	3.4	5.1	5.1	10.8	10.6	13.3	15.2	16.1
Months of imports[4]	0.7	1.5	1.0	1.1	1.1	1.9	1.9	2.5	2.9	3.1
Current account balance (percent of GDP)										
Excluding official transfers	-14.2	-17.0	-12.2	-18.3	-18.8	-16.0	-17.2	-16.1	-15.4	-15.3
Including official transfers	-4.8	-1.3	-5.9	-3.6	-4.7	-1.6	-1.6	-1.8	-2.2	-3.0
Value of exports of goods and services (percent change)	0.7	29.5	3.6	-3.6	-3.5	18.1	15.7	9.2	7.6	7.5
Value of imports of goods and services (percent change)	-6.2	23.7	-7.8	1.0	1.7	3.1	3.6	7.0	6.7	7.4
REER (percent change)	9.5	-6.0	-3.3	…	…	…	…	…	…	…
Overall balance (percent of GDP)	-2.0	2.2	-1.9	-0.1	0.6	3.7	3.5	3.4	3.3	2.8
Terms of trade (percent change)	7.7	1.9	-17.1	-3.3	-2.4	1.5	2.5	3.0	2.7	2.2

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

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

[2] Excluding SDR allocation.

[3] Figures for 2009 onward take account of Malawi's SDR allocation (SDR 55.4 million). Gross reserves are measured only from the balance sheet of the central

[4] Months of prospective imports of goods and nonfactor services.

Table 5. Malawi: External Financing Requirement and Sources, 2009–17

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total requirement	-625	-1072	-593	-862	-867	-856	-875	-895	-940
Current account, excluding official transfers	-715	-919	-687	-790	-655	-674	-705	-756	-816
Debt amortization	-9	-14	-14	-17	-24	-30	-33	-33	-33
Gross reserves accumulation (- increase)	99	-139	108	-55	-187	-153	-137	-105	-90
Total sources	625	1073	593	862	867	856	875	895	940
Expected disbursements (official)	545	954	480	685	700	699	705	706	708
Grants	471	850	357	591	595	599	605	606	608
Medium- and long-term loans	73	104	123	94	106	100	100	100	100
Private sector (net)	-6	98	113	139	115	143	178	216	256
IMF	86	21	0	37	52	14	-7	-28	-25
Drawings	0	21	0	40	60	40	20	0	0
Repayments	0	0	0	3	8	26	27	28	25
SDR allocation	86	0	0	0	0	0	0	0	0
Gross international reserves	141	280	190	215	403	556	693	798	888
Months of imports	0.7	1.5	1.0	1.1	1.9	2.5	2.9	3.1	3.2

Source: IMF staff estimates.

Table 6. Malawi: Proposed Schedule of Disbursements Under ECF Arrangement, 2012–15

(Millions of SDR)

Amount	% of Quota	Date available	Conditions Necessary for Disbursement	Status
13.02	18.75	July 23, 2012	Executive Board Approval of Three Year ECF arrangement.	Disbursed
13.02	18.75	December 15, 2012	Observance of performance criteria for September 30, 2012 and completion of first review.	Disbursed
13.01	18.75	April 15, 2013	Observance of performance criteria for December 31, 2012 and completion of second review.	
13.01	18.75	June 15, 2013	Observance of performance criteria for March 31, 2013 and completion of third review.	
13.01	18.75	December 15, 2013	Observance of performance criteria for September 30, 2013 and completion of fourth review.	
13.01	18.75	June 15, 2014	Observance of performance criteria for March 31, 2014 and completion of fifth review.	
13.01	18.75	December 15, 2014	Observance of performance criteria for September 30, 2014 and completion of sixth review.	
13.01	18.75	June 15, 2015	Observance of performance criteria for March 31, 2015 and completion of seventh review.	
104.10	150.00	Total for the ECF arrangement		

Source: IMF staff estimates.

Table 7. Malawi: Indicators of Capacity to Repay the Fund, 2012–22[1]

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Projected Payments based on Existing Drawings:										
(SDR millions)										
Principal	4.0	16.7	17.4	17.9	15.7	19.1	8.0	7.3	5.2	5.2
Charges and interest	0.0	0.1	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Projected Payments based on Existing and Prospective Drawings:										
(SDR millions)										
Principal	4.0	16.7	17.4	17.9	15.7	22.9	21.1	27.9	27.7	27.7
Charges and interest	0.0	0.1	0.5	0.5	0.5	0.4	0.4	0.3	0.3	0.2
Total Payments based on Existing and Prospective Drawings:										
SDR millions	4.1	16.7	17.9	18.4	16.2	23.3	21.5	28.2	28.0	27.9
US$ Millions	6.3	25.8	27.6	28.4	25.0	35.9	33.2	43.6	43.2	43.0
Percent of exports of goods and services	0.4	1.5	1.5	1.4	1.2	1.6	1.3	1.6	1.5	1.4
Percent of debt service	25.6	86.7	82.6	67.5	67.8	97.6	90.1	118.4	117.2	116.9
Percent of quota	5.8	24.1	25.8	26.5	23.3	33.6	31.0	40.7	40.3	40.2
Percent of gross official reserves	1.6	4.6	4.0	3.6	2.8	3.7	3.2	4.1	3.4	2.9
Projected Level of Credit Outstanding based on Existing and Prospective Drawings:										
SDR millions	168.6	189.5	190.9	173.0	157.3	134.4	113.3	85.4	57.7	30.0
US$ Millions	260.2	292.4	294.6	267.0	242.8	207.5	174.9	131.8	89.1	46.3
Percent of exports of goods and services	16.5	17.0	15.9	13.4	11.4	9.0	7.1	5.0	3.1	1.5
Percent of debt service	1066.4	982.1	880.8	636.1	659.3	563.5	475.0	358.1	241.9	125.8
Percent of quota	243.0	273.0	275.0	249.3	226.7	193.7	163.3	123.1	83.2	43.2
Percent of gross official reserves	64.6	52.6	42.5	33.5	27.3	21.3	16.9	12.3	7.0	3.2
Memorandum items:										
Exports of goods and services (US$ millions)	1573.1	1718.3	1849.5	1988.5	2138.4	2293.9	2461.1	2644.8	2847.0	3069.1
Debt service (US$ millions)	24.4	29.8	33.4	42.0	36.8	36.8	36.8	36.8	36.8	36.8
Quota (SDR millions)	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4
Gross official reserves (millions of U.S. dollars)	402.8	555.5	692.8	797.7	888.2	973.2	1035.1	1074.6	1271.2	1462.6
GDP (US$ millions)	3816.1	4178.1	4561.0	4951.9	5345.6	5777.9	6675.0	7531.5	8442.3	9468.7

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

[1] Assumes disbursements as per schedule in Table 6.

Table 8a. Malawi: Quantitative Targets, 2012[1]

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

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

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

Table 8b. Malawi : Quantitative Targets, 2013–14[1]

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

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

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

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

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

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

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

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

7 Defined as a cumulative flow.

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

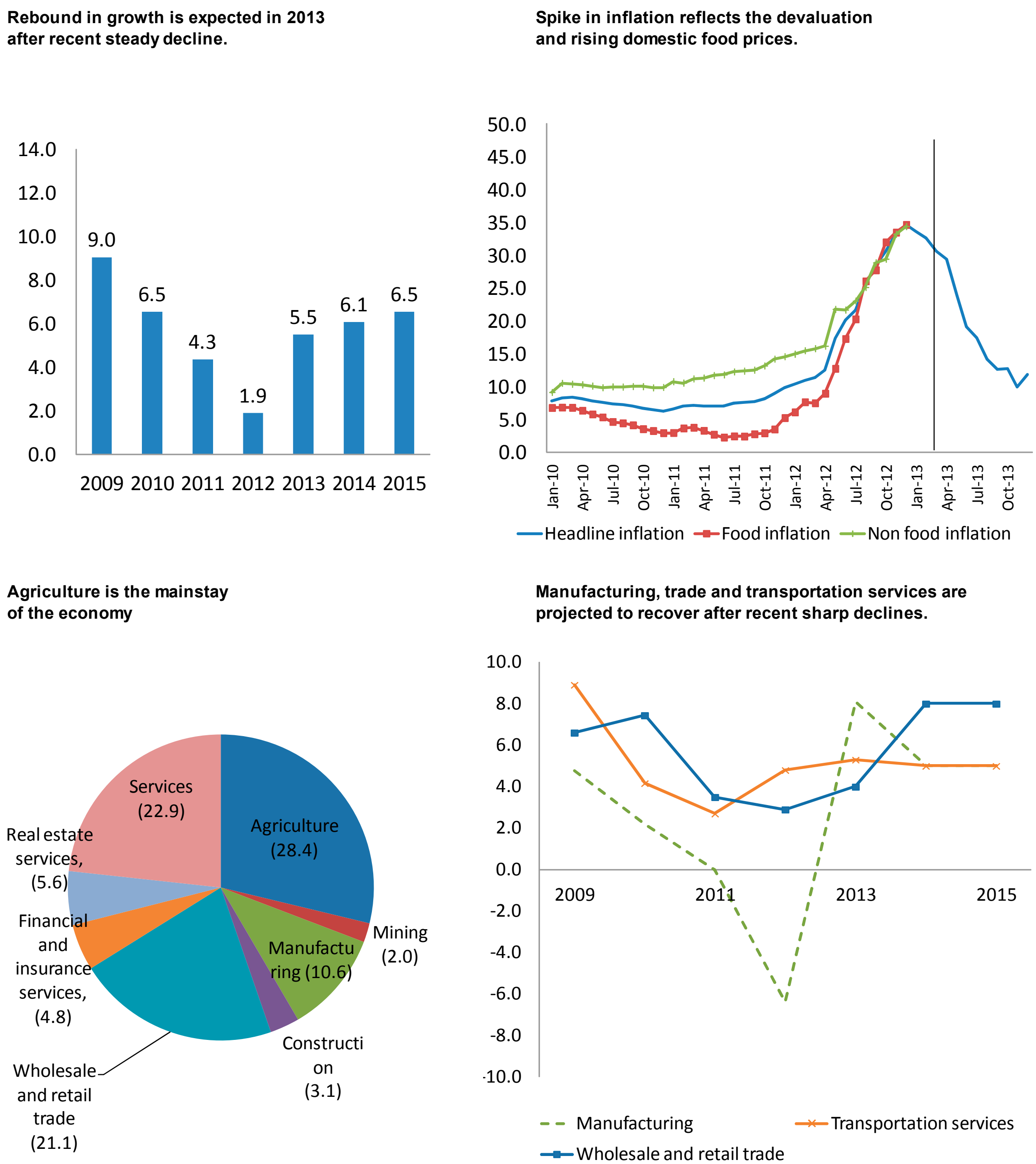
9 Evaluated on a continuous basis.

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

Table 9. Malawi: Prior Actions and Structural Benchmarks, 2012–13

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

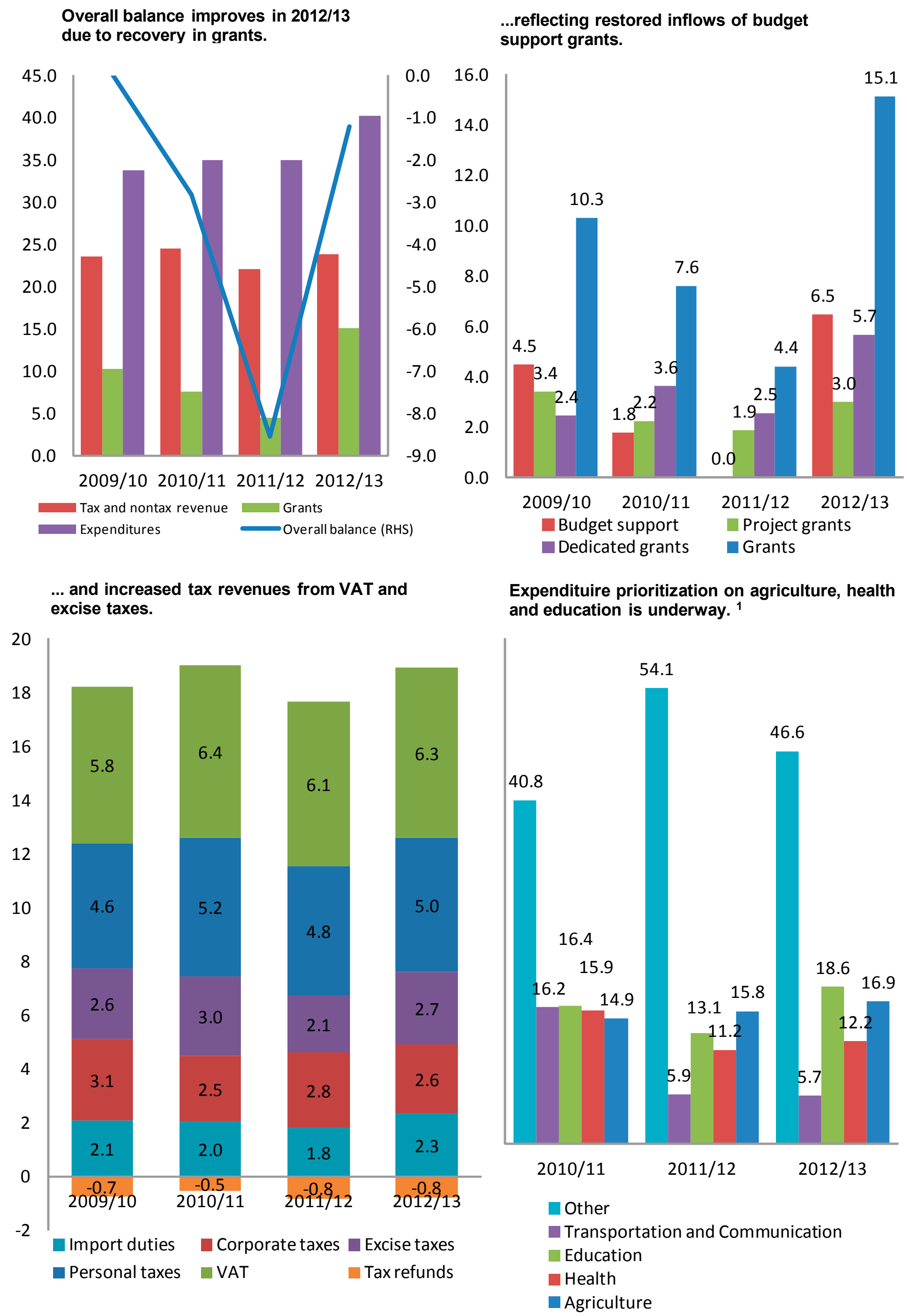
Figure 1. Malawi: Real Sector Developments and Prospects, 2009–15



Sources: Malawian authorities; and IMF staff estimates.

Figure 2. Malawi: Fiscal Developments, 2009/10–2012/13

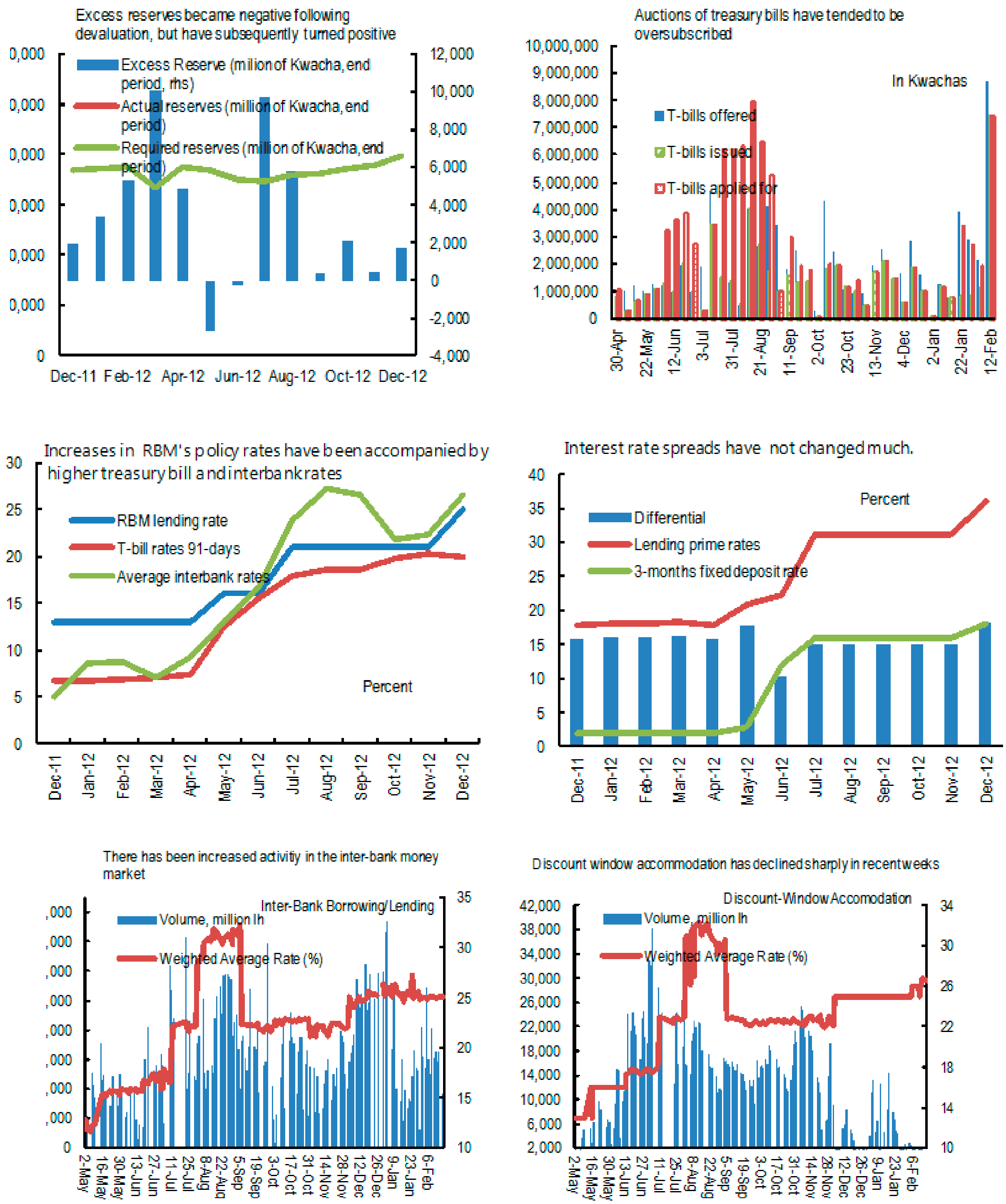
(Percent of GDP)



Sources: Malawian authorities and IMF staff estimates.

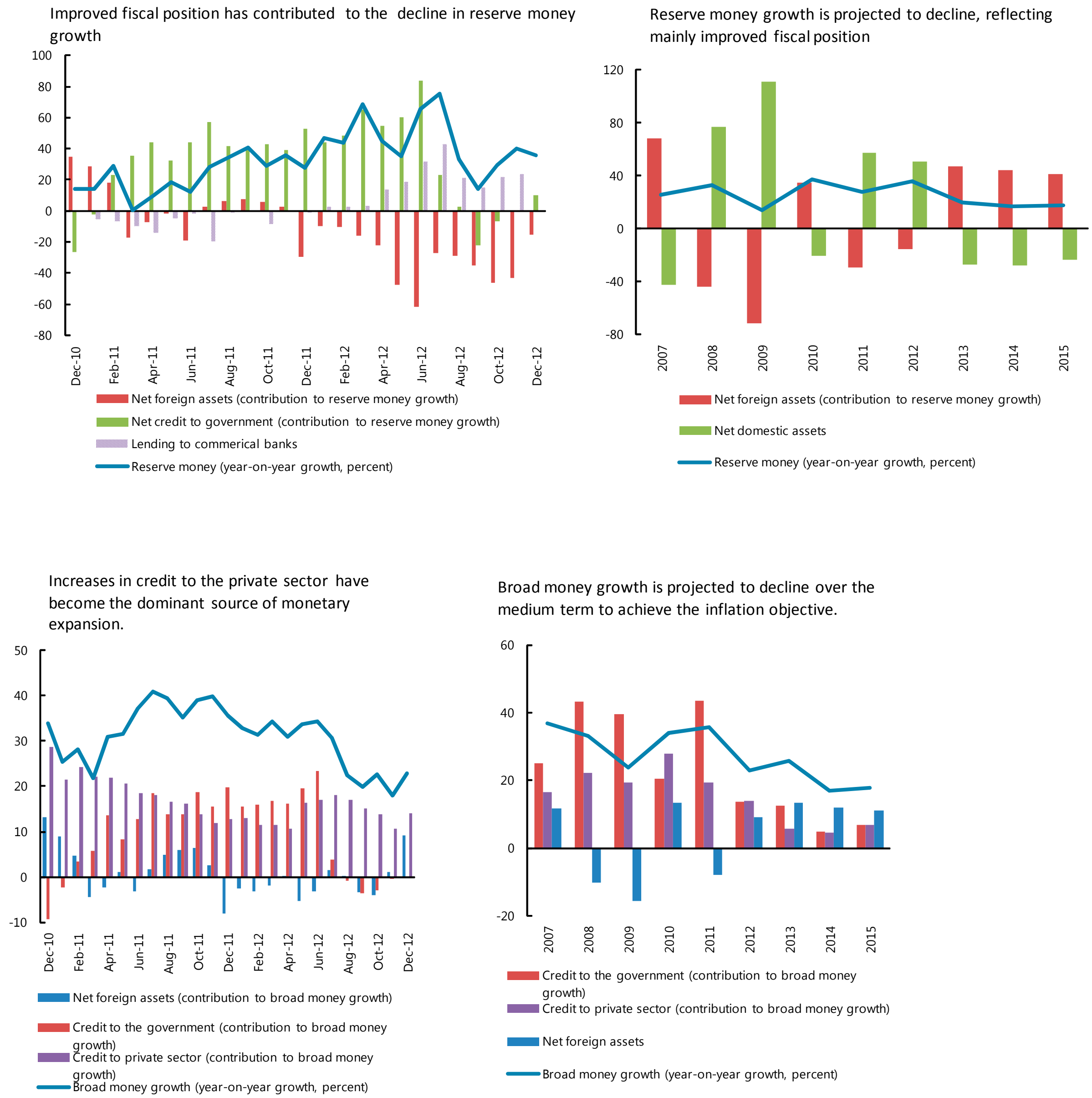
[1] Percent of total expenditures.

Figure 3a. Malawi: Interest Rates and Liquidity Developments



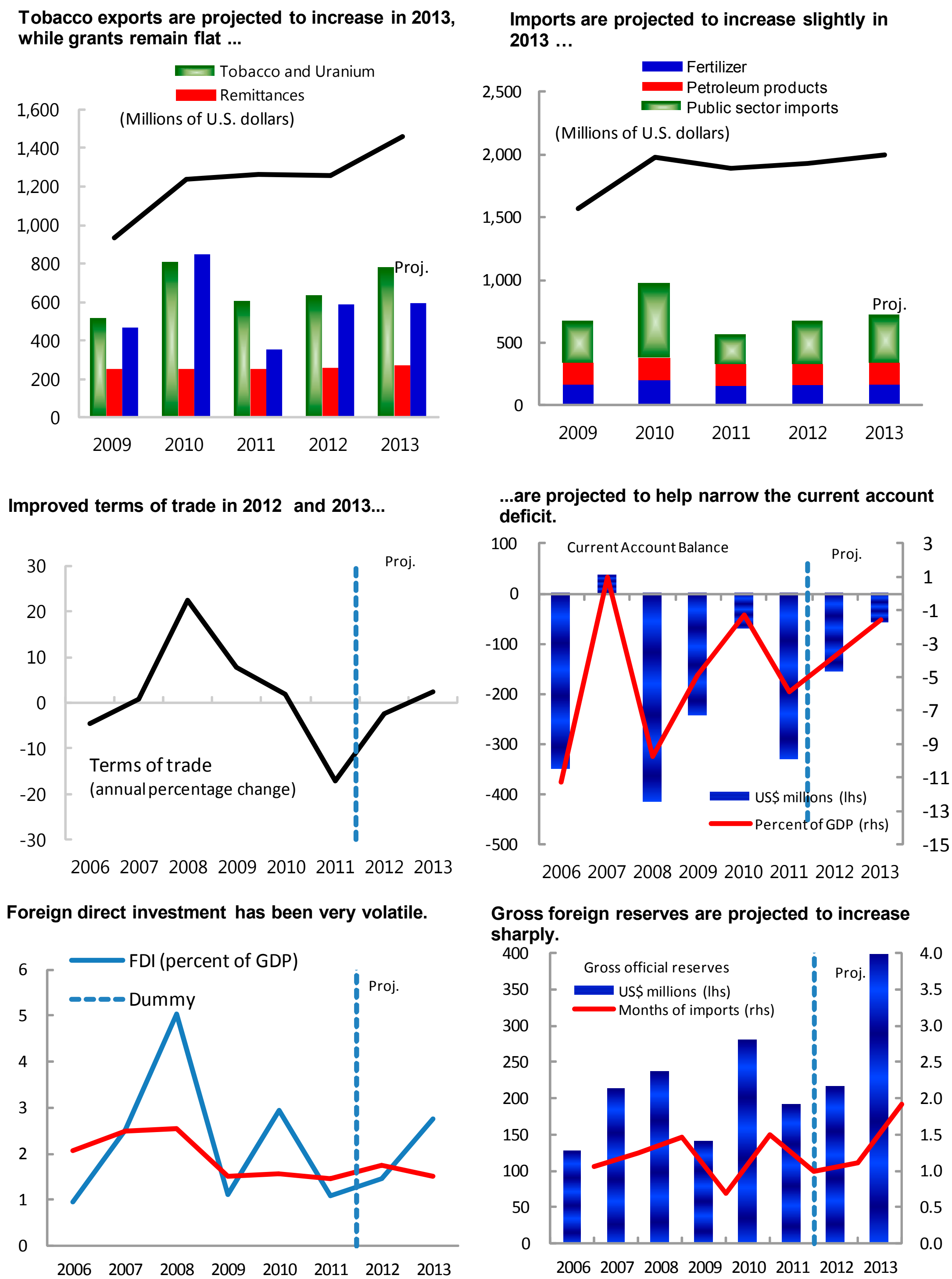
Sources: Malawian authorities and IMF staff calculations.

Figure 3b. Malawi: Monetary Developments, 2010–15



Sources: Malawian authorities and IMF staff calculations.

Figure 4. Malawi: External Sector Developments



Sources: Malawian authorities; and IMF staff estimates.

APPENDIX I—LETTER OF INTENT

March 28, 2013

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

Dear Madam Lagarde:

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

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

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

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

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

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

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

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

Yours sincerely

/s/

Dr. Ken Lipenga (MP)
Minister of Finance

/s/

Mr. Charles Chuka
Governor of the Reserve Bank of Malawi

Attachments:

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

ATTACHMENT I—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

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

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

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

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

Recent Economic Developments

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Performance under the Program

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

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

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

Medium-term Framework

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

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

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

Policies

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

A. Exchange Rate Policy

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

B. Monetary Policy and Financial Sector Issues

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

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

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

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

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

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

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

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

C. Fiscal Policy

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

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

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

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

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

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

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

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

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

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

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

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

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

D. Business Climate and International Competitiveness

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

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

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

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

Information Sharing, Data Quality and Capacity Building

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

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

Program Monitoring

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

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

ATTACHMENT II—TECHNICAL MEMORANDUM OF UNDERSTANDING

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

Coverage

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

Quantitative Performance Criteria: Definitions and Data Sources

A. Floor on Net International Reserves of the RBM

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

D. Ceiling on External Payment Arrears

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

E. Ceiling on Nonconcessional External Debt

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

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

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

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

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

Quantitative Indicative Targets and Structural Benchmarks

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

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

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

Reporting of Certain Transactions in the Fiscal Accounts

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

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

Exchange Regime

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

Reporting Requirements

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

Table 1a. Quantitative Targets[1]

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

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

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

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

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

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

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

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

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

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

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

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

7 Defined as a cumulative flow.

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

9 Evaluated on a continuous basis.

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

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

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

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

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

Source: International Financial Statistics.

[1] LBM connotes London Bullion Market.

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

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

Source: Malawian authorities.

Table 5. Reporting Requirements

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

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

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

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

APPENDIX II—MALAWI: REAL EXCHANGE RATE ASSESSMENT[1]

This note assesses the degree of exchange rate misalignment in Malawi until end-November 2012, using a high frequency time-series equilibrium real exchange rate (ERER) approach. The results suggest that the Kwacha is undervalued by 8 percent as at end-November 2012.

The reduced-form time series ERER approach to exchange rate assessment consists of three steps. First, a measure of monthly Commodity Terms of Trade (CTOT) is constructed for Malawi between 1990M1 and 2012M11 and a cointegrating relationship between the CTOT and the monthly Real Effective Exchange Rate (REER) is established. Second, fitted values of the equilibrium real effective exchange rates are derived from the estimated cointegrating vector. Third, the percentage deviations of the actual real effective exchange rates from their predicted values are calculated and treated as a measure of the exchange rate misalignment.

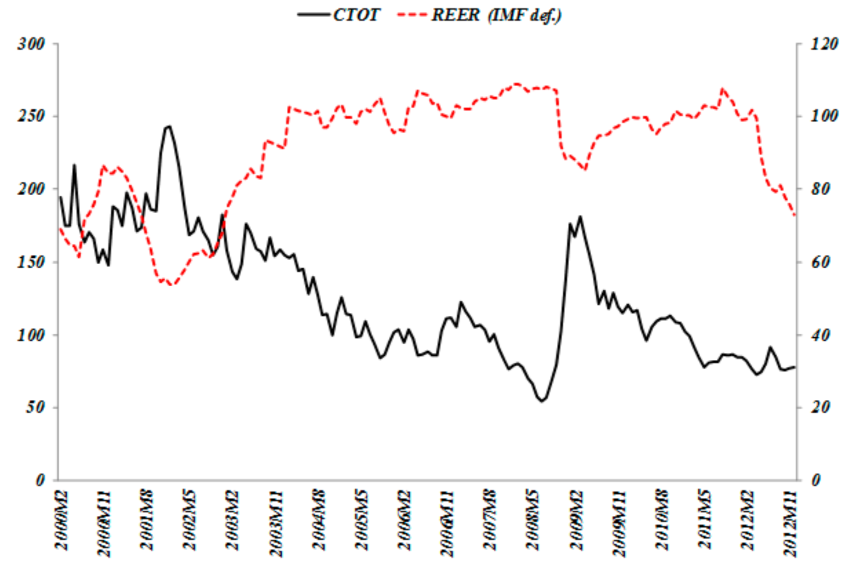
Fluctuations in the REER in Malawi have been negatively associated with changes in the commodity terms of trade in the last decade, which corresponds to a sub-sample of the period covered by the cointegrating relationship (Figure 1). Due to restrictive foreign exchange policies in the past, the REER has been moving in the opposite direction of the commodity terms of trade since 2000, resulting in an overvalued exchange rate in the first half of 2012. Our measure for the CTOT index is defined as:

$$CTOT_t = \prod_j \left(\frac{P_{jt}}{MUV_t}\right)^{X_j} / \prod_j \left(\frac{P_{jt}}{MUV_t}\right)^{M_j}$$

where MUV_t is a manufacturing unit value index used as a deflator, X_j (M_j) is the share of exports (imports) of commodity j in country i's GDP, and P_{jt} is the individual commodity price at time t. The commodities are: Tobacco, Uranium, Tea, Sugar, Cotton, Rice, Coffee, Maize, Petroleum Products, and Fertilizers. By construction, the movements in the CTOT index are due to changes in commodity prices as the export and import shares are taken as fixed and so remain constant over time. For empirical application, we calculate X_j and M_j as the average value of these shares between 1990 and 2011.

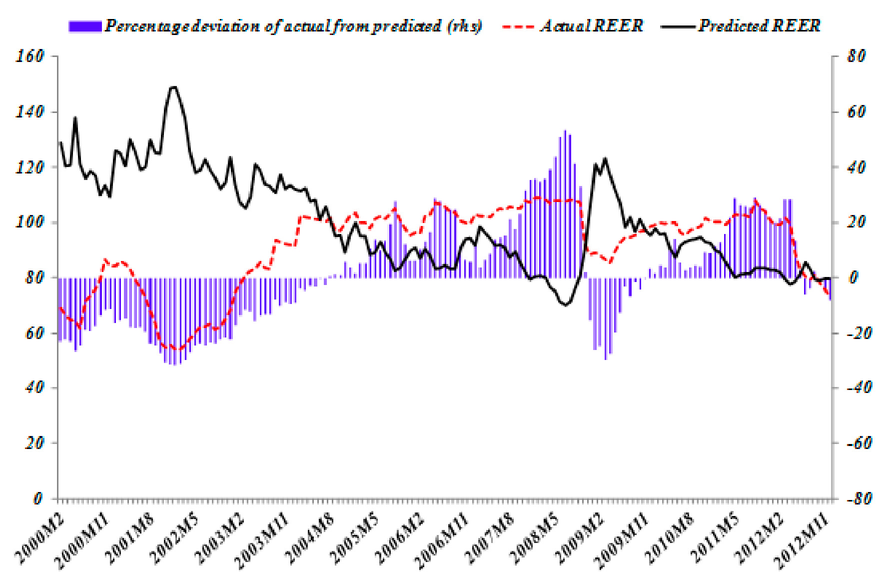
[1] Prepared by Mehdi Raissi (SPR).

Figure 1. Commodity Terms of Trade and REER, 2000M1–2012M11



The ERER approach suggests that the kwacha is undervalued. A high frequency estimation of the cointegrating relationship between the real exchange rate and the commodity terms of trade (as the only explanatory variable) shows that these two variables are cointegrated (with a statistically significant elasticity coefficient of 41.8 percent). The estimation suggests that the kwacha is undervalued by 8 percent at end-November 2012 (see Figure 2).

Figure 2. High Frequency ERER Estimation, 2000M1–2012M11



APPENDIX III—MALAWI: CORRELATION AND CLUSTER ANALYSES OF MONETARY INDICATORS, PRICE INDICES AND THE EXCHANGE RATE[1]

(May–December 2012)

1. We use simple statistical methods to investigate associations among monetary indicators, price indices and the exchange rate in the period since the May 2012 devaluation and related policy reforms. Based on correlations, we find the following (see Table below):

- Monetary aggregates and prices are strongly correlated, suggesting a role for monetary policy in achieving price stability.
- Non-food CPI shows strong correlation with the exchange rate; the correlation between the all-items CPI and the exchange rate is not as strong.
- Monetary aggregates are strongly correlated with the exchange rate, suggesting a role for monetary policy in achieving exchange rate stability.

Malawi: Correlation Matrix: Monetary Aggregates, Consumer Price Indices and Exchange Rate

(May–December, 2012)

	LC1	LC2	LM1	LM2	LM3	LCPIA	LCPINF	LEXR
LC1	1							
LC2	0.98	1						
LM1	0.86	0.92	1					
LM2	0.17	0.3	0.57	1				
LM3	0.58	0.68	0.82	0.88	1			
LCPIA	0.09	0.22	0.4	0.92	0.84	1		
LCPINF	0.32	0.43	0.53	0.85	0.9	0.96	1	
LEXR	0.74	0.82	0.82	0.62	0.91	0.65	0.81	1

Note

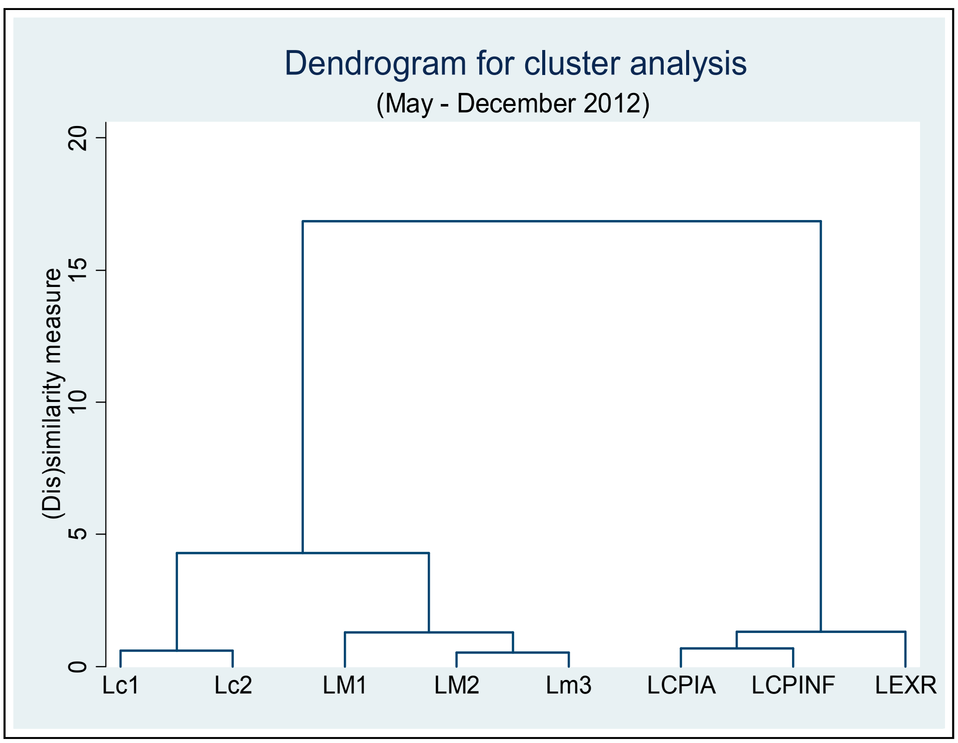
LC1	Log of currency outside the banking system
LC2	Log of currency in circulation (including banks' vault cash)
LM1	Log of M1 (currency outside the banking system and demand deposits)
LM2	Log of M2 (M1 plus time and saving deposits (kwacha)
LM3	Log of M3 (M2 plus foreign currency deposits)
LCPIA	Log of CPI Index (headline)
LCPINF	Log of non-food price index
LEXR	Log of average exchange rate

Source: IMF staff calculations.

[1] Prepared by O. Adedeji (AFR) and A. Mialou (STA).

2. We also conduct a cluster analysis for monetary aggregates, prices, and exchange rate to ascertain if these variables share common profiles. The cluster tree ("Dendrogram"), indicates the following (see chart below):

- There exists strong correlation among the various measures of monetary aggregates (LC1, LC2, LM1, LM2, LM3), as these variables are merged in the same cluster at a very small distance. This implies any of these variables can be used as an indicator of monetary policy.
- Headline CPI, non-food CPI and exchange rate show strong correlation, as these variables are merged in the same cluster at a very small distance. Aside from supply shocks, it appears that exchange rate movements have been a principal contributory factor to higher prices during May–December, 2012.
- Monetary aggregates merge on to prices and exchange rate, though at a much higher cluster.



APPENDIX IV—MALAWI'S NATIONAL EXPORT STRATEGY[1]

Malawi's National Export Strategy (NES) was officially launched in December 2012. It is a critical element in the implementation of the Malawi Growth and Development Strategy (MDGS II) and the Economic Recovery Plan. It provides a prioritised road map for developing Malawi's productive base and improving the country's export competitiveness. NES emphasizes four areas: export clusters, conducive business environment, supportive economic institutions to build the productive base of the economy, and competencies, skills and knowledge development. Implementation of the NES will be supported by pooling resources under the Trade, Industry and Private Sector Development Sector Wide Approach (TIPSD SWAp). The SWAp will integrate all the resources from government and development donors, improve the alignment, coherence and coordination of policy and program, and avoid overloading and duplication of efforts.

Priority Area 1 — Export Clusters

Three prioritized export-oriented clusters for diversification: These prioritized clusters can compete in target markets and drive exports through value addition, mostly to neighboring and regional markets (NES identifies the target markets for specific products). Three dedicated Technical Working Groups (TWGs), with appropriate representation of stakeholder groups, will be established to implement the cluster strategy. The clusters are:

1. **Oil Seed Products** — cooking oil, soaps, lubricants, paints, varnishes, meals and flours, bio-fuel, animal feed, fertilizer, snacks and confectionery derived from sunflower, groundnuts, soya and cotton

2. **Sugar Cane Products** —– sugar, high value sugar through branding, sugar confectionery (such as syrups, sweets, caramel etc), sweetener, ethanol, spirits, cane juice, fertilizer, animal feed, electricity, cosmetics

3. **Manufactures** — beverages, agro-processing (including dairy, maize, wheat, horticulture and pulse value addition), plastics, packaging, and assembly.

Supporting exports of existing clusters: The NES includes plans for supporting stakeholders in other major existing clusters: tobacco, mining, tourism, tea and services.

Priority Area 2—Conducive Environment

[1] Prepared by Jing Peng (AFR).

Develop an environment conducive to economic competitiveness and economic empowerment of youth, women, farmers and MSMEs, including through affordable access to reliable energy, cost-effective transport, finance, ICT, trade facilitation, etc. It also addresses the disconnection between smallholder farmers and processors/markets for value addition. Other issues covered in this priority include land reform, seed, irrigation, warehouse receipts, policy coherence, comprehensiveness and strategic focus.

Priority Area 3—Supportive Economic Institutions to Build the Productive Base of the Economy

Invest in supportive economic institutions and organizations, including ensuring sufficient funding and staffing. The NES commits to securing budgets for staff in Malawi Investment and Trade Centre (MITC), Small and Medium Enterprise Development Institute (SMEDI), Ministry of Labour, and Dept of Agriculture. It also aims to improve communication through ongoing dialogue and devoting high-level attention to develop agencies that are central to the development of Malawi's productive base and export competitiveness.

Priority Area 4—Competencies, Skills and Knowledge

Invest significantly in competencies, skills and knowledge which help to lay the foundation of Malawi's productive base and its export capacity. A National Competencies & Skills Plan will be developed to link prioritised clusters, key sectors and a Labour Market Information System effectively maintained by Ministry of Labour and Technical, Entrepreneurial and Vocational Education and Training (TEVET).

ANNEX I

RELATIONS WITH THE FUND

(As of January 31, 2013)

Membership Status

Joined: July 19, 1965; Article VIII

General Resources Account:

	SDR Million	%Quota
Quota	69.40	100.00
Fund holdings of currency (exchange rate)	66.96	96.69
Reserve tranche position	2.44	3.52

SDR Department:

	SDR Million	%Allocation
Net cumulative allocation	66.37	100.00
Holdings	0.58	0.87

Outstanding Purchases and Loans:

	SDR Million	%Quota
ESF Arrangements	34.70	50.00
ECF Arrangements	83.04	119.65

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	07/23/2012	07/22/2015	104.10	26.04
ECF[1/]	02/19/2010	02/18/2013	52.05	13.88
ESF	12/03/2008	12/02/2009	52.05	34.70

[1]Formerly PRGF.

Projected Payments to Fund [1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2013	2014	2015	2016	2017
Principal	5.37	16.66	17.35	17.86	15.71
Charges/Interest	0.05	0.05	0.27	0.23	0.19
Total	5.42	16.71	17.62	18.08	15.90

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

Implementation of HIPC Initiative:

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	December 2000
Assistance committed	
by all creditors (US$ Million)[1]	1057.00
Of which: IMF assistance (US$ million)	45.27
(SDR equivalent in millions)	33.37
Completion point date	Aug 2006
Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	33.37
Interim assistance	11.57
Completion point balance	21.80
Additional disbursement of interest income[2]	3.82
Total disbursements	37.19

[1] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts cannot be added.

[2] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

Implementation of Multilateral Debt Relief Initiative (MDRI):

MDRI-eligible debt (SDR Million)[1]	37.87
Financed by: MDRI Trust	14.53
Remaining HIPC resources	23.34

Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
December 2006	N/A	7.91	7.91
September 2006	10.84	19.12	29.96

[1] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

Safeguards Assessments:

An update safeguards assessment of the Reserve Bank of Malawi was conducted with respect to the current ECF arrangement. The RBM continues to publish financial statements that are prepared and audited in accordance with international standards. However, the assessment reiterates a key safeguards concern – the lack of operational autonomy - and recommends that already envisaged amendments to the RBM Act to limit lending to government be expanded to strengthen RBM autonomy more broadly. Other recommendations focus on enhancing oversight of foreign reserves management and improvements to data compilation procedures. The latter includes measures to strengthen transparency of contingent liabilities arising from letters of credit that can have implications for program data. The RBM is committed to implementing the assessment's recommendations. The recommendations of the assessment do not require action in the context of the first review and will be closely monitored going forward.

Exchange Arrangements:

During the second review of the PRGF arrangement in August 2006, a multiple currency practice (MCP) under Article VIII emerged (manifested by the significant spread between the commercial bank exchange rates and the rates at foreign exchange bureaus). In May 2012, the government liberalized the foreign exchange regime, devalued the kwacha by about 33 percent and adopted a floating exchange rate regime. Staff is in the process of reviewing recent reforms to make an assessment of Malawi's exchange rate system. Malawi maintains restrictions on the capital account. While the de jure exchange rate arrangement is floating, staff's latest assessment classified the de facto arrangement as "other managed".

Article IV Consultation:

Malawi is on a 24-month Article IV consultation cycle. The last Article IV Consultation mission was conducted in conjunction with the discussions on the new ECF-supported program arrangement in May/June 2012. The Executive Board concluded the last Article IV consultation with Malawi on July 23, 2012.

Financial Sector Assessment Program (FSAP), Reports on Observance of Standards and Codes (ROSCs), and Offshore Financial Center (OFC) Assessments:

A joint team of the World Bank and the International Monetary Fund visited Malawi under the FSAP program during two missions in July and December 2007. The Financial System Stability Assessment (FSSA) was issued in June 2008 (SM/08/198).

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

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

Technical Assistance:

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
03/13	FAD	Ministry of Finance	Public Financial Management	Mission
02/13	STA	RBM	RBMS' monetary statistics	Mission
02/13	FAD	Ministry of Finance	GFS 2001	Mission
11/12	STA	NSO	Prices Statistics	Mission
10/12	MCM	RBM	Liquidity Management, Monetary Operations and Related Issues	Mission
10/12	FAD	Ministry of Finance/MRA	Revenue Administration	Mission
05/12	STA	NSO	Consumer Price Indices Mission	Mission
04/12	STA	NSO	Balance of Payments Statistics	Mission
04/12	STA	NSO	Provide advice to improve the GDP methodology and assist with improving the data sources and indicators	Mission
04/12	STA	NSO	Balance of Payments and International Investment Position Statistics	Mission
03/12	FAD	Ministry of Finance	Strengthening the IFMIS control environment	Mission
03/12	FAD	Ministry of Finance	Public Financial Management (PFM) Reforms	Report
03/12	FAD	Ministry of Finance/MRA	Follow-up and Consolidating Headquarters functions and Customs Risk Management Mission	Mission
01/12	MCM	RBM	Review of Implementation of Risk Based Supervision	Report
01/12	FAD	Ministry of Finance	Developing a Draft Budget Framework Document (BFP)	Mission
12/11	FAD	Ministry of Finance	Public Financial Management (PFM) Reforms	Mission
12/11	MCM/LEG	RBM	Review the Foreign Exchange Regime	Mission
11/11	FAD	Ministry of Finance	Macro fiscal training	Mission
11/11	MCM	RBM	Development of asset management manual.	Mission
11/11	MCM	RBM	Further Development of a Framework for Consolidated Supervision	Report
11/11	FAD	Ministry of Finance	Improving capacity in Business process re-engineering and IT implementation.	Mission
10/11	FAD	Ministry of Finance	Program Budgeting and Developing the Medium-term Expenditure Framework	Mission

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
			Cycle	
06/11	FAD	Ministry of Finance	Measures for Tax Reform and Taxation of Mining	Mission
06/11	FAD/MRA	Ministry of Finance	Enhancing taxpayer compliance and revenue performance	Mission
06/11	STA	Ministry of Finance	Government Finance Statistics	Report
06/11	FAD	Ministry of Finance	Macro-fiscal training, scoping and needs assessment	Mission
06/11	MCM	RBM	Developing AML/CFT Offsite Supervisory Tools and Practices	Mission
06/11	FAD	Ministry of Finance/MRA	Malawi: Enhancing Tax Compliance and Revenue Performance	Report
06/11	FAD	Ministry of Finance/MRA	Tax Administration	Mission
06/11	FAD	Ministry of Finance	Measures for Tax Reform and the Taxation of Mining	Mission
05/11	FAD	Ministry of Finance	Fixed Assets and Financial Reporting	Mission
05/11	FAD	Ministry of Finance/MRA	Report on Strengthening Headquarters functions and Customs Risk Management Mission	Mission
04/11	STA	NSO	Incorporate new source data in the balance of payments and develop new worksheets	Mission
04/11	MCM	RBM	Assisting Reserve Bank of Malawi to further develop a framework for consolidated supervision	Mission
04/11	MCM	RBM	Developing Capacity for Stress Testing - Mission Report to the Reserve Bank of Malawi	Report
02/11	STA	NSO	Assess SUT and B-I prerequisites, data sources, compilation and dissemination for NAS	Mission
02/11	STA	NSO	Review of National Accounts Statistics	Report
01/11	FAD	Ministry of Finance	Streamlining Budget Documentation, Revising Budget Circular, Reintroducing MTEF	Mission
11/10	FAD	Ministry of Finance	Integrated Financial Management Information System (IFMIS): Review And Implementation Strategies	Report
11/10	STA	RBM	Monetary and Financial Statistics	Mission
11/10	MCM	RBM	Regulation and Oversight of Mobile Payments and Related Issues	Mission
10/10	STA	NSO	Assist in reviewing and modifying the PPS and PPI.	Mission
10/10	FAD	Ministry of Finance	IFMIS/Cash Management	Mission
10/10	FAD	Ministry of Finance	Program Budgeting/Output Budgeting	Mission
10/10	FAD	Ministry of Finance	In-year Fiscal Reporting/Budget Documentation	Mission
10/10	FAD	Ministry of Finance	Joint review of PFMRP	Mission
10/10	FAD	Ministry of Finance	Strengthening Program Budgeting,	Report

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
			Performance Measurement, and Budget Documentation.	
08/10	FAD	Ministry of Finance	Revenue Policy and Administration	Report
07/10	FAD	Ministry of Finance	Strengthening the large taxpayers office	Mission
07/10	FAD	Ministry of Finance	Installation of expert and revenue Administration follow up mission (including review of ITAS implementation)	Mission
07/10	STA	NSO	Implementation of Balance of Payments Standards	Mission
07/10	STA	NSO	Balance of Payments and International Investment Position Statistics	Report
06/10	FAD	Ministry of Finance	Issues in Tax Policy and Taxation of Mining	Mission
05/10	MCM	RBM	Training in Techniques of Stress Testing of Prudential Data	Report
05/10	FAD	Ministry of Finance	Revenue Policy and Administration	Report
01/10	FAD	Ministry of Finance	Output-based budget and expenditure tracking	Mission
01/10	STA	NSO	Balance of payments statistics	Mission
10/09	MCM	RBM	Central bank policy	Mission
10/09	MCM	RBM	Central banking	Mission
09/09	FAD	Ministry of Finance	Improving output budgeting	Mission
08/09	LEG	Ministry of Finance	Tax procedure code	Mission
05/09	LEG	Ministry of Finance	Tax procedure code	Mission
05/09	FAD	Ministry of Finance	Linkage between policy and budgetary allocations	Mission
04/09	FAD	RBM	Monetary operations and reserves management	Mission
03/09	FAD	Ministry of Finance	Revenue administration	Mission
03/09	FAD	Ministry of Finance	Prepare modernization plan and support tax administration	Mission
02/09	FAD	Ministry of Finance	Integration of accounting systems and fiscal reporting	Mission
02/09	MCM	RBM	Currency handling and reform	Mission
02/09	MCM	RBM	Monetary operations/money markets	Mission
01/09	STA	RBM	DFID: Money and banking statistics	Mission
01/09	MCM	RBM	Monetary operations/money markets	Mission
01/09	MCM	RBM	Macro and FSI Analysis	Mission
01/09	MCM	RBM	TA coordination/evaluation	Mission

Annex II

JOINT MANAGERIAL ACTION PLAN

(As of January 31, 2013)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
A. Mutual information on relevant work programs			
Bank work program in the next 12 months	**Analytical and Advisory Activities:** 1. Public Expenditure Review 2. Agriculture PER 3. Diagnostic Trade Integration Study 4. Poverty Policy Note 5. Higher Education and Skills Development Policy Note 6. Decentralization Note 7. PPP Pipeline Screening Assessment 8. Update of Malawi Transport Costs Study **Lending:** 1. First Programmatic Development Policy Operation (budget support) 2. Higher Education and Skills Development Project 3. Agricultural Productivity Program for Southern Africa (APPSA)	November 2012 September 2012 November 2012 On-going On-going On-going Work being finalized TBA November February 2013 December 2013	September 2013 April 2013 August 2013 May 2013 June 2013 April 2013 January 2013 December 2013 May 2013 July 2013 March 2013
IMF work program in next 12 months	1. Second review of ECF-supported program 2. Third review of ECF-supported program 3. Fourth review of ECF-supported program	February, 2013 May 2013 November 2013	April 2013 June 2013 December 2013
B. Requests for work program inputs			
Fund request to Bank	1. Information on budget support and costing of social safety net programs		February–March 2013.
	2. Updates on Public Expenditure Review work		December 2012, January 2013 April 2013 August 2013
Bank request to IMF	1. Regular updates of medium-term macro projections		Continuous
C. Agreement on joint products and missions			
Joint products in next 12 months	1. Debt Sustainability Analysis (update)	April/May 2013	May/June 2013

ANNEX III

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of January 31, 2013)

AfDB operations in Malawi date back to 1969. The Malawi Field Office was opened in 2007 and officially launched in July 2008 by AfDB President Dr. Donald Kaberuka. As at January 31, 2013, the Bank had provided significant and diversified support to Malawi, with cumulative commitments worth UA 775.6 million (about US$ 1.2 billion) to finance 95 operations including 11 studies and 2 lines of credit.

Over the period of 2011 to 2012, AfDB's assistance to Malawi was anchored on the Interim Country Strategy Paper (ICSP, 2011-12), which was approved by the Bank's Board of Directors on 11th May 2011. The ICSP was framed within the context of the Malawi Growth and Development Strategy (MGDS, 2006–11) and the Bank's Medium-Term Strategy (2008–12). The ICSP identified two pillars, infrastructure development and private sector development to be the focus of the Bank's development assistance to Malawi. During the ICSP period, the ADF XII allocation for Malawi for 2011 amounted to UA 70 million (about USD 108 million) with 44 percent of the resources provided as grants.

The AfDB Board of Directors on 30th January 2013 approved a new Country Strategy Paper (CSP) covering 2013–17. The Bank's new CSP is fully aligned to the second Malawi Growth and Development Strategy (MGDS II) covering the period 2011–16, the Bank's corporate priorities in the Long Term Strategy (LTS, 2013–22) and the Regional Integration Strategy Paper for Southern Africa (Southern African RISP, 2011–15). The Bank has held extensive consultations with all relevant key stakeholders to determine the priorities for intervention. The new CSP will focus on two pillars: (i) addressing infrastructure bottlenecks to competitiveness and growth; and (ii) supporting actions to expand private sector investment and trade. To ease challenges posed by Malawi's landlocked position, the Bank will scale-up support to regional infrastructure to deepen the country's integration with its neighbors. Accordingly, more than 50 percent of the indicative lending operations are regional and will be financed with ADF XII, XIII and XIV resources. The Bank will also support Public Private Partnerships (PPPs) in infrastructure development.

Box. AfDB Ongoing Operations.

The Bank's ongoing operations comprise the following: three projects in the agriculture sector: (i) Agriculture Infrastructure Support Project (AISP); (ii) Small-holder Crop Production and (iii) Marketing Project (SCPMP) and Climate Adaptation for Rural Livelihoods and Agriculture Project (grant from Global Environment Facility). The Bank is also implementing the National Water Development Programme (NWDP) in collaboration with Australian AID (AusAID), whilst the grants from the African Water Facility (AWF) are financing Strengthening Water Sector Monitoring & Evaluation Project and the Water and Sanitation Access project for the Urban Poor in the City of Blantyre which is aimed at improving access to improved water supply and sanitation services. There are currently four projects providing support to the social sector: (i) the Health SWAp Programme which is constructing and rehabilitating a total of 57 health facilities across the country; (ii)the Local Economic Development project is developing infrastructure in four rural growth centres of Jenda, Malomo, Monkey Bay and Chitekesa; (iii) the Competitiveness and Job Creation Project in Private sector which aims to improve the capabilities and the competitiveness of the private sector as well as increase export diversification and job creation ; and (iv) Support to Higher Education Science & Technology Project aims to increase access to technical, entrepreneurship, vocational and training (TEVET) and higher education in Malawi, with particular emphasis to Information and Communication Technology (ICT). In the transport sector the Bank is implementing the Trunk Roads Rehabilitation Project which includes Blantyre-Zomba road rehabilitation project (60 km) and the Lilongwe Bypass construction Project (13km) as part of the Multinational Nacala Road Corridor. As at the end of January 2013, the overall portfolio was rated satisfactory with a cumulative disbursement rate of 44%. In line with the CSP indicative program, the Bank prepared two new operations, the Mzuzu-Nkhata Bay Road Rehabilitation Project (US$ 33.20) and Smallholder Irrigation and Value Addition Project (US$39.98 - Funded by Global Agriculture and Food Security Project and the African Development Fund). The projects were approved in March 2013.

Following Governments reengagement with the IMF and the approval of a new US$ 157 million Extended Credit Facility (ECF) arrangement for Malawi in July 2012, the Bank approved a new ADF Grant for the Crisis Response Budget Support operation for Malawi in July 2012, in the amount of US$ 40 million. The Bank designed a Restoration of Fiscal Stability and Social Protection (RFSSP) program whose objective is to contribute to restoring fiscal stability and enhancing public finance management in Malawi, as well as support social protection measures to mitigate the adverse social impact of the devaluation of the Kwacha and the increases in fuel and electricity prices. In order to support this agenda, the RFSSP has two components: (i) strengthened PFM transparency and accountability, and (ii) strengthened social protection system. The grant of US$40 million is the largest single tranche budget support provided by the ADF in Malawi. It is important to note that the total programmed amount for the RFSSP was UA 30 million. However, the provision of UA 26 million (US$ 40 million equiv.) was on account of inadequate resources at the time of the program appraisal. The Bank will therefore make available the balance of UA 4 million (US$ 6 million equiv.) as supplementary budget support in the first half of 2013.

The Bank is encouraged by the government's renewed commitment to restoring and sustaining sound fiscal and monetary policy reforms for recovery and sustained growth.

The Bank has also provided support for non-lending activities, including feasibility studies (Songwe River Basin Development Study and Shire Zambezi Water Development Feasibility Study) and analytic work to inform the design of new operations and policy dialogue. The Bank prepared a Private Sector Profile for Malawi and has also financed jointly with the World Bank and other partners a Public Expenditure Review expected for completion in August 2013.

ANNEX IV

STATISTICAL ISSUES

Introduction

1. Although economic data provision has some shortcomings, it is broadly adequate for surveillance.

2. The data module of the Report on the Observance of Standards and Codes (data ROSC), published February 17, 2005, found that, while the institutional framework for the production of macroeconomic statistics was broadly adequate, there were shortcomings in the scope, accuracy, and reliability of data. The weakest areas are: national accounts, balance of payments statistics, government finances statistics, and monetary and financial statistics. A key STA recommendation was 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 RBM.

3. The authorities are making efforts to improve the quality and timeliness of economic and financial data through participation in the Fund's General Data Dissemination System (GDDS) and the GDDS Project for Anglophone African Countries. Malawi is participating in the GDDS/PRSP and the monetary and financial statistics modules of the project. GDDS metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since February 2007.

National accounts

4. The accuracy and reliability of the real sector data (including national accounts, prices, and trade) are affected by inadequate source data and timeliness. STA has recommended remedial actions, including the need for additional resources for the National Statistics Office (NSO). A long-term technical assistance program in the area of national accounts is being provided under a project by Norwegian counterparts. The NSO have revised the national accounts methodology to implement the SNA93 and to better account for the activities in the informal sector. New estimates for Real and Nominal GDP based on the base year 2007 are submitted.

Consumer prices

5. A consumer price index (CPI) is available on a timely basis. The CPI base is 2000, drawing on the 1997/98 household survey, and data (on urban and rural price indices) are collected on a monthly basis by regional price collectors. The CPI weights have been revised based on the 2010 planned Integrated Household Survey (IHS) and the new series will be available in March 2013.

Government finance statistics

6. The accuracy and reliability of the data are affected by inadequate source data. A key shortcoming in this area is inadequate system of recording source data. In addition, 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 Malawi Government (MG) Account.

- Nontax revenue, including capital revenues collected by line ministries are not properly accounted for in the fiscal reports prepared by the Ministry of Finance.

- Data on recurrent expenditure suffer from serious shortcomings partly related to insufficient bank reconciliation between expenses records prepared by line ministries and financing information prepared by the Ministry of Finance. Line ministries submit spending reports to the Ministry of Finance based on recorded expenses, while the Ministry of Finances estimates expenses based on funding data (from the Credit Ceiling Authority). 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 estimates are based on funding released to line ministries, and estimates 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 expenses and corresponding financing data. In addition, many donor projects are still not incorporated in the budget, and hence the corresponding expenditure is not captured in government finance statistics. Some externally funded development expenditures are likely recurrent and reported capital expenditure therefore overstated.

- 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.

- Malawi's current budget classification includes economic and program classification and program, but does not include an effective administrative/organizational classification.[2] Expenditure data is loosely mapped to functional classification based on the CoFoG classification.

[2] Economic classifications were upgraded to GFS 2001 compatible framework in FY 2006/07.

- 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 have been 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. Under the ECF program, the government is expected to develop a mechanism for properly monitoring social expenditures.

- The government nomenclature program/subprogram currently used for the functional classification seems appropriate considering the nature of the items classified under this group. The items currently classified under this group include functions, programs and administrative levels. Although substantial elements of the current output based budget structure appear to be predominately functional in nature, it is not clear whether they are cleanly linked to classification of functions of government (CoFoG). As such, the government should review the current budget structure and the functional classification based on CoFoG (GFSM2001) to verify that they are aligned.

- The absence of a financial administrative structure, complete with vertical hierarchy of responsibilities inhibits the use of Government Finance Statistics (GFS). Budget funds are directed to organizations generally defined as cost centers (e.g., headquarters of ministries down to the level of secondary school principals). As such, there does not appear to be an effective hierarchal financial system. However, to be clear, over the past two years, sub-votes have been introduced to a number of Ministries, but not as yet, a system of warrants and sub-warrants have not been introduced.

- 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 lagged. The government has pledged to strengthen public financial management and fiscal reporting, and renewed efforts are being made to establish a work plan, including utilizing donor technical assistance more effectively. The authorities are currently working with East AFRITAC to modify its chart of accounts and output-based structures so that they could more easily be realigned to the national strategy and can be readily understood.

8. Government finance data are not reported for publication in the *Government Finance Statistics Yearbook (GFSY)* or the *International Financial Statistics (IFS)*. An August 2005 and August 2007 STA mission that visited Lilongwe reiterated the importance of continued efforts to implement the Integrated Financial Management Information System (IFMIS), and encouraged the authorities to improve the coverage and sectorization of government financial operations and to correctly classify transactions according to international guidelines. The mission proposed, and

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

9. A GFS TA mission visited Lilongwe in June 2011 in the context of the country's participation in the GFS Module under the Enhanced Data Dissemination Initiative funded by DFID. It found that annual and sub-annual data for budgetary central government are compiled in *GFSM 1986* format of the Ministry of Finance, but are not disseminated. A new chart of accounts aligned with the *GFSM 2001* was introduced in the 2011–12 budget cycle, which applies to all general government units. A number of source data issues were identified and recommendations made to address them. Bridge tables linking the national classifications and *GFSM 2001* classifications were prepared by the mission, and should be revised and used to compile GFS in *GFSM 2001* format. A follow up mission is included in the RAP for FY 2013.

Monetary and financial statistics

10. Despite recent improvements, monetary and financial statistics (MFS) continue to have shortcomings. These includes irregular reporting to STA, lack of proper legislation to grant the authority to the RBM to require reporting from other institutions[3]; the sectorization of the domestic economy, and classification of financial instruments to ensure that the RBM adheres fully to the methodology of the *Monetary and Financial Statistics Manual*. The 2004, 2008, 2009, and 2010 missions noted and made a number of recommendations for addressing the above shortcomings. In addition to the above tasks, the 2008, 2009, and 2010 STA missions assisted RBM staff in developing the standardized report forms (SRFs) for the central bank accounts (1SR), other depository corporations (2SR), and monetary aggregates (5SR).

External sector statistics

11. The external sector statistics in Malawi exhibit serious deficiencies. 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),* although there has been some progress in the transition to the methodology of *BPM5*. The National Statistical Office of Malawi (NSO) should now adopt the *BPM6* methodology, on the basis of which the Malawi balance of payments metadata should also be updated. Balance of payments data remain weak in a number of key areas. The NSO balance of payments section remains crucially understaffed, as it has been since March 2008. Moreover, important data sources for balance of payments compilation ceased to be available during 2006–07, for example exchange control forms, which could supply information on imports of goods, services, and current transfers. Procedures for assessing the accuracy of trade data need to be improved.

[3] Some legislation that is designed to address this issue has recently been approved. However, some of the pending legislation would give and strengthen the authority of the RBM in this regard.

12. The NSO had compiled new balance of payments data and validated the results from two key surveys: the BOP Survey and the survey on nonprofit institutions serving households (NPISH), both based on the *BPM*5 methodology. The NSO also compiled information from other important sources as well, namely: a) the 2009 Foreign Private Capital and Investor Perception Survey, b) monetary statistics from the Reserve Bank of Malawi (RBM), and c) other financial data provided by the Ministry of Finance (MoF). However, much remains to be done to improve the quality, coverage, and timelines of the balance of payments statistics.

13. Data on remittances are non-existent, despite anecdotal evidence that there are high remittances. As a first step the money transfer services should be required to report monthly data to the RBM. Data on foreign direct investment and portfolio flows are similarly weak. Project aid is currently classified as current transfers rather than in the capital account, and several large in-kind projects are not captured in the balance of payments data properly.

14. No international investment position statement is prepared. The RBM and Ministry of Finance's Debt and Aid Department need to improve reporting of monetary and external debt data respectively.

Malawi: Tables of Common Indicators Required for Surveillance

(As of January 31, 2013)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8]	
						Data Quality – Methodological soundness[9]	Data Quality – Accuracy and reliability[10]
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	01/2013	01/2013	M	M	M		
Reserve/Base Money	01/2013	01/2013	M	M	M		
Broad Money	01/2013	01/2013	M	M	M		
Central Bank Balance Sheet	01/2013	01/2013	M	M	M	LO, LO, LNO, O	LO, O, O, O, O
Consolidated Balance Sheet of the Banking System	01/2013	01/2013	M	M	M		
Interest Rates[2]	01/2013	01/2013	M	M	M		
Consumer Price Index	01/2013	01/2013	M	M	M	O, LNO, O, O	LNO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	12/2012	12/2012	M	M	I		
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/2012	12/2012	M	M	I	O, LO, O, O	O, LO, O, O, LNO
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/2012	12/2012	M	M	M		
External Current Account Balance	12/2012	12/2012	A	A	A		
Exports and Imports of Goods and Services	12/2012	12/2012	A	A	A	O, O, O, O	LO, O, LO, O, O
GDP/GNP	12/2012	12/2012	A	A	A	LO, LNO, LNO, LO	LNO, LNO, LO, LO, LNO
Gross External Debt	2011	6/2012	M	I	I		
International Investment Position[6]	NA	NA	NA	NA	NA		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including 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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

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

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

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

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

INTERNATIONAL MONETARY FUND

EXTERNAL RELATIONS DEPARTMENT

Press Release No. 13/108
FOR IMMEDIATE RELEASE
April 8, 2013

International Monetary Fund
Washington, D.C. 20431
USA

IMF Executive Board Completes Second Review Under the Extended Credit Facility Arrangement for Malawi and Approves US$19.6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Malawi's economic performance under a program supported by the Extended Credit Facility (ECF) arrangement. The Board's decision enables the immediate disbursement of an amount equivalent to SDR 13.02 million (about US$19.6 million), bringing total disbursements under the arrangement to an amount equivalent to SDR39.06 million (about US$58.7 million).

The three-year ECF arrangement for Malawi in the total amount of SDR 104.1 million (about US$156.2 million) was approved on July 23, 2012 (see Press Release 12/273).

Following the Board's discussion, Mr. David Lipton, First Deputy Managing Director and Acting Chair, issued the following statement:

"Malawi's performance under the Fund-supported program has been commendable despite a difficult environment. The policy reforms have begun to yield positive results, including increased availability of foreign exchange. The government also successfully rolled out its social protection programs.

"Continued tight monetary policy and fiscal restraint are needed to contain aggregate demand, stabilize the exchange rate and prices, and boost international reserves. The Reserve Bank of Malawi (RBM) is committed to maintaining a tight monetary stance until inflation pressures recede. The fiscal authorities are also committed to implementing prudent policies in the run up to the 2014 general elections. In particular, the FY2013/14 budget will include measures to offset the impact of recent wage increases on the budget. The authorities are also pursuing reforms to broaden the tax base, improve revenue administration, and exercise greater control over expenditures.

"It will be important to safeguard the stability of the financial system. The RBM is strengthening its oversight of banks and is assessing the true financial condition of all banks with a view to enforcing prudential regulations. It has also enhanced its monitoring of banks that have continued to have difficulty meeting liquidity requirements.

"The authorities are making progress in implementing structural reforms to enhance the country's competitiveness and exports. They are committed to removing regulatory hurdles to doing business in Malawi."

Statement by Mr. Momodou Bamba Saho, Executive Director for Malawi

April 8, 2013

Since April 2012, the Malawi government under the leadership of President Banda has continued to focus on implementing tough but critical macroeconomic and structural reforms aimed at turning around the economy. The government initiated a series of measures aimed at accelerating the economic adjustment program that was approved by the IMF Board last July. The policy initiatives cover a broad range of areas: fiscal policy, revenue administration, public financial management, monetary policy and structural reforms. My authorities have taken a pro-active approach to dealing with the challenges facing the country. With their current policy stance and the normalization of support from the international community since August 2012, as well as policy guidance from the Fund, my authorities are confident that they stand a good chance of shoring up their economy's growth to its normal trajectory and achieving macroeconomic stability. My authorities broadly agree with the staff report as it presents a generally balanced assessment of recent macroeconomic developments and challenges and opportunities in the Malawian economy. My authorities reaffirm their commitment to the program as set out in their Memorandum of Economic and Financial Policies document.

Outcome of Recent Economic Policies

From its inception, the main objectives of the Fund-supported program have been to assist Malawi address the macroeconomic imbalances and regain its macroeconomic stability and set the stage for long-term development. To this end, the policy reforms so far have yielded some positive results, with the liberalization of the exchange rate attracting more foreign exchange inflows into the system and the re-establishment of some of the international credit lines. However, the exchange rate has continued to depreciate markedly partly as a result of pressures arising from the clearance of private sector external payments arrears that were much higher than estimated at the start of the program. Consequently, official international reserves have declined fueling perceptions in the market of continued scarcity of foreign exchange. Furthermore, the weak performance of tobacco and sugar, have weakened Malawi's current account balance. The government has also continued to implement the automatic pricing adjustment mechanism for fuel. While the depreciation of the kwacha and the fuel price adjustments have increased the cost to consumers, the fuel supply situation has improved markedly.

My authorities recognize that policies may be inadequately implemented unless there is a parallel strengthening of the underlying administrative procedures and that ownership of the program by the citizens is a fundamental ingredient for its success. On the structural front significant achievements have been made since the beginning of the Fund-supported program. The Malawi Revenue Authority continues to publish monthly revenue collections; quarterly expenditure ceilings for line ministries ensure overall spending does not exceed the resource envelope; and the purchase order module of IFMIS is progressively being extended to all procurements, strengthening government commitment controls. To enhance effectiveness of RBM monetary operations, a memorandum of understanding between the RBM and Ministry of Finance has been signed clearly outlining the Ministry of Finance's responsibility for meeting the interest costs of T-bills used for monetary operations.

Political Economy of the Reform Efforts

Over the past 10 months Malawi has achieved impressive macroeconomic adjustments. In particular, the authorities devalued the currency by 33 percent and concurrently adopted a floating exchange rate regime. The price of foreign exchange has since increased further by more than 50 percent. They also adopted an automatic price adjustment mechanism for petroleum products and adjusted utility tariffs, effectively removing government subsidies to fuel and utilities consumption. Monetary policy was tightened by increasing the policy rate by 12 percent to 25 percent. However, despite the tight monetary policy stance, including through open market operations, the continuing depreciation of the exchange rate and drought induced increases in local food prices have triggered the inflation rate to edge up to 37.9 percent in February. My authorities expect their policy actions would result in moderating the inflation rate by May/June.

There is a need to be mindful that the effects on the real economy have been far-reaching and painful, resulting in a growing public outcry as well as strikes by civil servants and other workers demanding higher wages over austerity measures and falling living standards due to the unintended negative consequences of the fiscal, monetary and exchange rate policies which have been implemented to achieve macroeconomic stability and sustainable growth. Even though the government implemented a social protection program aimed at ameliorating the impact of the reforms on the poor and vulnerable groups, it became necessary to address the growing pressures from rising social tensions. The authorities granted civil servants a wage increase, mostly for the lowest pay grades, funded through cuts and savings from other parts of the budget. This has helped in mitigating the discontent and in ending the strikes.

In addition, bank credit to the private sector has continued to weaken. Commercial banks' base lending rate, currently at 40 percent and the accumulation of arrears by the public sector has hindered activity by firms, including entrepreneurial initiatives to move to export-oriented sectors. My authorities consider that such developments risk eroding the ownership of the adjustment program among significant sections of the population.

Nevertheless, despite the painful austerity measures, support for the ongoing reforms is continuing with envisaged recovery in 2013. There has also been some improved acceptability of the reforms by the general public as a result of periodic communications by the authorities as well as awareness campaigns.

Conclusion

My authorities have asked me to convey their deep appreciation to the Fund Executive Board and Management for their continued engagement and support. They are grateful to the Fund Mission for the constructive approach in providing policy advice and in helping the authorities build much needed capacity. In particular, my authorities want to thank the team for helping in identifying capacity shortfalls and for responding expeditiously to their requests for Fund technical assistance. By staying the course, my authorities are confident that Malawi is about to turn a new page on the long and arduous road towards growth and broad-based economic prosperity. In support of the continuing efforts by the government and the people of Malawi, my authorities are requesting the Board's approval of the completion of the second review of the ECF program and modification of performance criteria.