INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/345

MALAWI

December 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Malawi, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 11, 2015 consideration of the staff report that concluded the Article IV consultation with Malawi.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 11, 2015, following discussions that ended on September 30, 2015, 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 November 30, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Malawi.

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

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 15/115
FOR IMMEDIATE RELEASE
December 14, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Malawi

On December 11, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the 2015 Article IV consultation[1] with Malawi.

Bold economic reforms undertaken in mid-2012, namely the devaluation of the currency, the adoption of a floating exchange rate regime, the liberalization of foreign exchange markets, and the introduction of an automatic fuel price adjustment mechanism transformed the policy environment and greatly improved the outlook of the economy. But uneven policy implementation, high inflation, and a weak balance of payments position–dependent on a narrow export base and financed by volatile donor inflows–continue to pose macroeconomic challenges. Furthermore, the "cashgate" scandal uncovered in 2013 involving a large-scale theft of public funds damaged Malawi's economic outlook significantly. The subsequent withdrawal of donors' budgetary support and fiscal and monetary policy slippages prevented the achievement of key objectives of sustainable and inclusive growth, and low inflation under Malawi's Growth and Development Strategy. Over 2012–14, real GDP growth and inflation averaged 4.3 percent and 24.5 percent, respectively.

The economic outlook remains difficult reflecting the negative impact of weather-related shocks, the ongoing suspension of budget support, persistently high inflation and weaker global demand which could hurt Malawi's exports. Real GDP growth is projected to fall by 2.7 percentage points to 3 percent in 2015 due in large part to heavy floods in early 2015 followed by drought which resulted in an estimated decline of about 30 percent in the maize harvest (the main staple). As a result, an estimated 2.8 million persons remain at risk of food insecurity. Growth is projected to rise gradually to about 5.5 percent over the medium term. Inflation is expected to rise to 25.4 percent at end-2015 and is estimated to ease in 2016 and reach single digits at end-2017 if fiscal and monetary policies tighten, and international prices for food and petroleum products remain low. The external current account deficit will remain in the 8 percent range over the medium term reflecting the demand for imports associated with developmental projects, rapid population growth, and the slow pace of export diversification.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors expressed concerns about the policy slippages that have prevented Malawi from achieving sustained growth and low inflation. They agreed that the outlook is subject to downside risks from continued weather related supply shocks, the interruption of donor budget support, and weaker demand for Malawi's exports. Accordingly, Directors emphasized that restoration of macroeconomic stability was a critical near term priority. In this context, they underlined the need for fiscal consolidation and tighter monetary policy. Going forward, with implementation of sound macroeconomic policies and structural reforms, Directors expected growth to rebound gradually over the medium term along with a decline in inflation.

Directors underscored the benefits of improved revenue mobilization to respond to rising demand for public services from a rapidly growing population and to reduce aid dependence. Directors recommended broadening the tax base, strengthening tax compliance, and modernizing tax administration. Directors emphasized that ensuring medium term fiscal sustainability while safeguarding social spending will require improvements in the allocation and targeting of public spending. Directors stressed the need to accelerate public financial management reforms to restore trust and confidence in the budget process and foster donor re-engagement. Directors also cautioned that the envisaged changes should not make public sector pensions fiscally untenable.

Directors welcomed Malawi's commitment to the flexible exchange rate regime and the automatic fuel pricing mechanism, both of which have served Malawi well. They cautioned that changes to the fuel import regime involving a greater role for the state-owned company should be transparent and include safeguards against the emergence of contingent liabilities for the budget.

Directors called for intensified efforts to enhance financial sector resilience and its role in fostering inclusive growth. They noted that credit and concentration risks pose a significant threat to banking system stability and warranted continuous vigilance.

Directors encouraged the authorities to implement structural reforms to remove supply bottlenecks, increase agricultural productivity and improve the business environment.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Malawi: Selected Economic Indicators, 2012–18

	2012	2013	2014	2015	2016	2017	2018
	Act.	Act.	Est.	Proj.			
National accounts & prices (% change, unless otherwise indicated)							
GDP at constant market prices	1.9	5.2	5.7	3.0	4.5	5.2	5.5
Nominal GDP (billions of Kwacha)	1,502	2,011	2,570	3,198	3,933	4,564	5,190
GDP deflator	17.7	27.3	20.9	20.8	17.7	10.3	7.8
Consumer prices (end of period)	34.6	23.5	24.2	25.4	13.6	9.3	8.2
Consumer prices (annual average)	21.3	28.3	23.8	21.9	19.8	11.8	8.8
Investment and savings (percent of GDP)							
National savings	2.8	4.0	3.9	4.9	5.1	5.2	5.4
Gross investment	12.1	12.7	12.0	12.8	12.9	13.0	13.1
Government	5.8	5.3	4.6	6.6	5.6	5.8	5.6
Private	6.3	7.4	7.5	6.2	7.3	7.2	7.5
Saving-investment balance	-9.3	-8.7	-8.1	-7.9	-7.8	-7.8	-7.7
Central government (percent of GDP on a fiscal year basis)[1]							
Revenue	18.7	27.5	22.8	21.4	22.4	22.2	22.5
Tax and nontax revenue	15.6	17.3	19.7	18.6	18.5	18.6	18.9
Grants	3.1	10.2	3.1	2.8	3.9	3.5	3.6
Expenditure and net lending	23.5	28.5	28.9	27.1	26.2	24.7	25.3
Overall balance (excluding grants)	-7.9	-11.2	-9.2	-8.5	-7.7	-6.1	-6.4
Overall balance (including grants)	-4.8	-1.0	-6.1	-5.7	-3.8	-2.5	-2.8
Foreign financing	1.1	1.9	2.0	2.5	3.1	2.2	2.8
Domestic financing	4.7	-0.1	4.2	3.3	0.7	0.3	0.1
Discrepancy	-1.1	-0.8	-0.1	0.0	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	22.9	35.1	20.7	31.8	21.3	14.8	16.4
Net foreign assets	9.3	26.5	20.6	23.8	15.0	5.9	9.0
Net domestic assets	13.6	8.6	0.1	8.0	6.3	8.8	7.5
Credit to the government	0.0	11.3	-5.9	2.3	-0.6	0.4	0.1
Credit to the private sector (percent change)	25.4	14.4	20.0	15.1	16.5	18.6	19.5
External sector (US$ millions, unless otherwise indicated)							
Exports (goods and services)	1,421	1,657	1,751	1,558	1,698	1,861	1,943.2
Imports (goods and services)	2,282	2,315	2,388	2,186	2,264	2,452	2,556.0
Gross official reserves	236	397	588	683	745	772	895.4
(months of imports)	1.2	2.0	3.2	3.6	3.6	3.7	3.7
(percent of reserve money)	69.1	108.3	130.3	143.8	146.9	142.3	150.8
Current account (percent of GDP)[2]	-9.3	-8.7	-8.1	-7.9	-7.8	-7.8	-7.7
Current account, excl. official transfers (percent of GDP)[2]	-12.3	-10.0	-8.1	-8.3	-8.0	-7.8	-7.6
Real effective exchange rate (percent change)	-17.9	-14.9	8.8	…	…	…	…
Overall balance (percent of GDP)	1.6	3.1	2.7	1.0	0.5	0.9	2.0
Terms of trade (percent change)	-2.6	1.1	1.5	11.1	-1.5	-3.0	-1.1
Debt stock and service (% of GDP, unless otherwise indicated)							
External debt (public sector)	20.1	25.5	26.6	34.0	31.7	30.0	30.4
NPV of external debt (percent of exports)	53.3	77.3	102.7	117.2	103.6	89.2	84.9
Domestic public debt	13.8	19.8	14.9	14.0	13.4	12.4	11.1
Total public debt	33.8	45.3	41.5	48.0	45.1	42.3	41.4
External debt service (percent of exports)	1.4	1.7	4.2	9.5	11.4	9.5	4.9
External debt service (percent of revenue excl. grants)	2.1	2.8	6.6	12.4	16.3	13.6	7.2
91-day treasury bill rate (end of period)	20.0	32.3	26.9	…	…	…	…

Sources: Malawian authorities and IMF staff estimates and projections.

[1] The fiscal year starts in July and ends in June. The current financial year, 2015, runs from July 1, 2014 to June 30, 2015.

[2] Numbers reflect re-classification of project and dedicated grants from current account to capital account.

INTERNATIONAL MONETARY FUND

MALAWI

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

November 30, 2015

KEY ISSUES

Context: Malawi's persistent macroeconomic problems arise from uneven policy implementation, high inflation, and a weak balance of payments position that is financed by volatile donor inflows. Inadequate adjustment following the "cashgate" scandal involving the theft of public funds contributed to fiscal imbalances that damaged Malawi's economic outlook significantly. Fiscal and monetary policy slippages and the lack of progress on key program-related PFM reforms put the Fund-supported ECF arrangement off track and weakened donor confidence. Against this backdrop, Malawi has so far been unable to achieve its key objectives of sustainable growth and low inflation under its growth and development strategy.

Outlook and risks: The economic outlook remains difficult due to the negative impact of weather-related shocks, the ongoing suspension of budget support, and persistently high inflation. Short-term risks are tilted to the downside as a looming food crisis—owing to a steep decline in the maize harvest—which is projected to impact 2.8 million persons, continues to weigh on the outlook. Additional risks arise from weaker global demand which could hurt Malawi's exports. The exchange rate and the automatic fuel pricing mechanism would serve as shock absorbers in mitigating adverse global developments.

Policy discussions: Discussions focused on restoring macroeconomic stability in the near term through the pursuit of tighter fiscal and monetary policies geared toward placing inflation on a declining trend. In addition, accelerating the implementation of public financial management reforms is critical to re-establishing trust and confidence in the budget process. Over the medium term, policies should concentrate on safeguarding macroeconomic stability, improving the quality of spending, mobilizing revenues, addressing supply-side bottlenecks, and mitigating negative feedback loops from macroeconomic policies on the real and financial sectors.[1] Continued vigilance over the financial sector is warranted as credit risk poses a significant threat to financial stability.

[1] Since Malawi is a pilot on the mainstreaming financial sector surveillance initiative, this report highlights the macro-financial links throughout its analysis.

Approved By
David Owen (AFR) and Luis Cubeddu (SPR)

Discussions took place in Lilongwe during September 16–30, 2015. The mission was led by Mr. Williams (AFR). Other members of the mission team were Messrs Nsengiyumva and Wu (both AFR), Mr. Peralta-Alva and Ms. Lizarazo-Ruiz (both SPR), Ms. Sin (FAD), Mr. Oestreicher (resident representative), and Mr. Maehle (MCM) who contributed from headquarters. Mr. Mkwezalamba and Mr. Sitimawina (OED) participated in the discussions. The mission met with Minister of Finance Goodall Gondwe, Reserve Bank of Malawi (RBM) Governor Charles Chuka, other senior government and RBM officials, as well as, representatives of the business community, civil society organizations, and Malawi's international development partners.

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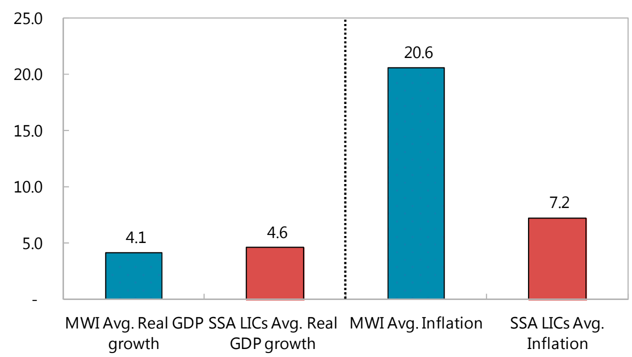
CONTEXT

1. Malawi's long-lingering macroeconomic difficulties arise from uneven policy implementation, high inflation, and a weak external position. As a result, Malawi has been a long-term user of IMF resources, including most recently under the Extended Credit Facility arrangement approved in July 2012. Bold economic reforms undertaken in mid-2012, namely the devaluation of the currency, the adoption of a floating exchange rate regime, the liberalization of foreign exchange markets, and the introduction of an automatic fuel price adjustment mechanism transformed the policy environment and greatly improved the economic outlook (Annex I). Nevertheless, heavy dependence on volatile aid flows, a narrow export base, and fiscal dominance have had adverse effects on the rest of the economy, posing challenges for macroeconomic stability.

2. Adverse shocks and policy slippages prevented the achievement of the key objectives of sustainable growth and low inflation under Malawi's growth and development strategy (MGDS II). Against this background, real GDP growth of 7.2 percent and single-digit inflation that were targeted over the period 2011–16 proved to be elusive, in part because of a succession of large shocks. In particular, the uncovering of a large-scale theft of public funds in 2013 ("cashgate") damaged Malawi's macroeconomic outlook significantly, owing to the sudden withdrawal of 4½ percent of GDP in budget support. Inadequate fiscal adjustment relative to the program given the suspension of donor budget support has resulted in increased recourse to domestic financing.

Text Figure 1. Malawi vs. SSA LICs

(Percent, 2011–15)



Sources: Malawian authorities' data and IMF staff estimates.

3. Program implementation has proven to be difficult in the face of ongoing external financing shortfalls and policy slippages which have put the program off track. While end-June targets on net domestic assets (NDA) and net international reserves of the central bank were met, net domestic financing (NDF) was missed by a large margin (2 percent of GDP). All PFM-related structural benchmarks—the centerpiece of the program's structural agenda—were missed, which has contributed to delays in the resumption of budget support. However, good progress was made in implementing those related to the financial sector. The seventh review has been postponed pending the adoption of measures to bring the program back on track.

RECENT DEVELOPMENTS

4. **The newly elected government after the May 2014 elections committed to rebuilding trust in public institutions and correcting macroeconomic imbalances.** While it was initially able to bring the Fund program back on track, responding to wage demands arising from persistently high inflation and meeting unplanned recruitment in the education sector led to policy slippages.

5. **Recent weather-related shocks have negatively impacted the economy (Figures 1–4).**

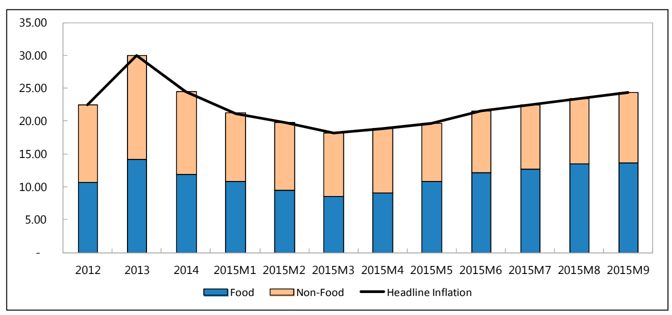
- ***Growth:*** Heavy floods in early 2015 followed by drought have resulted in an estimated decline of about 30 percent in the maize harvest (the main staple). Real GDP growth in 2015 has been revised downward by 2.7 percentage points to 3 percent (Figure 1). GDP was rebased (Box 1).

- ***Food insecurity:*** The steep decline in the maize harvest has created severe food insecurity for an estimated 2.8 million persons (about 16 percent of the population).

- ***Inflation:*** Annual inflation declined by 6 percentage points from end-2014 to 18 percent in March 2015, owing to the effects of tight monetary policy[2], currency appreciation, and lower international fuel prices. However, this trend quickly reversed as inflation rose sharply to 24 percent at end-September, led by rising food prices and a sharp depreciation of the kwacha. The kwacha like other regional commodity-dependent currencies depreciated (30 percent) against the U.S. dollar. In response, the central bank (RBM) introduced a number of directives aimed at slowing the pace of depreciation and later intervened through sales of foreign exchange. Expectations also played a role as average inflation has been stuck above 20 percent since 2012, in addition to the second round effects from recent public wage increases.

Text Figure 2. Malawi: Decomposition of Headline Inflation

(2012–Sep 2015)



Sources: Malawian authorities' data and IMF staff estimates.

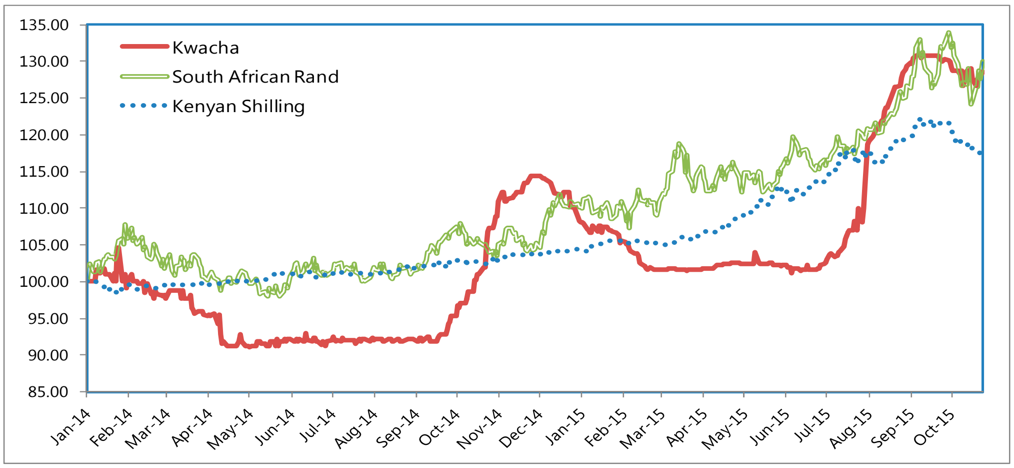
- ***Credit*****:** Growth in credit to the private sector—negative in real terms—continued its downward trend due to persistently high inflation, economic uncertainties, and tighter bank lending conditions.

[2] The policy rate was raised by 250 basis points to 25 percent in November 2014, combined with a directive requiring that the current liquid reserve requirement (15.5 percent) be imposed on the foreign currency deposit equivalent in local currency.

- ***External sector*:** The external current account deficit is estimated to have narrowed to about 8 percent of GDP in 2014, compared to 8.7 percent of GDP in 2013 reflecting lower export earnings, the impact of weaker aggregate demand on imports, and ongoing external financing shortfalls.

Text Figure 3. Regional currencies vs. the U.S. Dollar

(Jan 1st, 2014=100)



Source: IMF staff estimates.

6. Fiscal slippages (2 percent of GDP) emerged during FY14/15. These arose in large part from the unplanned recruitment of 10,500 teachers and the granting of unbudgeted wage increases (1¼ percent of GDP),revenue shortfalls (½ percent of GDP) and shortfalls in external flows (1 percent of GDP) (Text Table 1). Corrective actions were inadequate and less than ideal, comprising an equal mix of one-off revenue measures and expenditure cuts which may have adverse implications for medium-term growth and poverty reduction.

Text Table 1. Malawi: Sources of Fiscal Slippages in FY2014/15[1/]

	Billions of MWK	Percent of GDP
Slippages:		
Tax revenue shortfalls	18	0.6
External financing shortfalls	27	0.9
Wage bill	34	1.2
Interest expense	10	0.4
Corrective measures		
One-off revenues	-10	-0.4
Subsidies and transfers	-6	-0.2
Capital spending (domestic)	-10	-0.4
Other	-6	-0.2
Net domestic financing	57	2.0

Source: IMF staff estimates.

[1] Relative to the program.

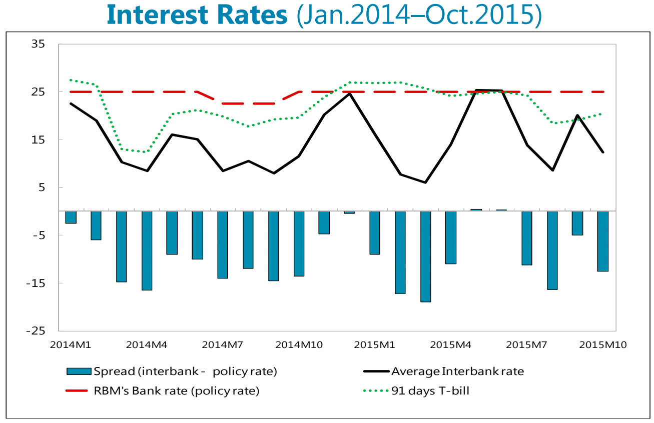
Box 1. Rebasing Gross Domestic Product

- **The National Statistical Office (NSO) of Malawi recently rebased their nominal GDP series from calendar year 2007 to 2010.** The 2010-based national supply and use table has been used to derive a new GDP series, which was revised upwards by 29 percent.
- **The rebasing has fundamental implications for economic analysis.** Some key indicators have changed significantly. The revenue-to-GDP ratio in FY2010/11 declined from 24.5 percent to 15.6 percent and the public debt-to-GDP in 2011 fell by 12 percentage points of GDP to 28.1. The lower debt ratios provide additional fiscal space, but the revised revenue ratios underline the scope for increased revenue mobilization.

7. **Despite increasing inflationary pressures, the RBM relaxed the stance of monetary policy in July 2015 by lowering the liquid reserve ratio (LRR), adding to pressure on the kwacha.** The move was intended to stimulate the real economy by reducing nominal lending rates. Although the policy rate remained unchanged, the cut in the LRR from 15.5 percent to 7.5 percent caused excess banking system liquidity to rise by about 1¼ percentage points of GDP. As a result, short-term market interest rates and returns on government securities, which had been positive in real terms, fell sharply, opening a large gap with the policy rate. Sterilization efforts have now absorbed the excess liquidity but key interest rates remained negative in real terms (Figure 2). The RBM increased the policy rate by 200 basis points in early November.

8. **The various shocks to Malawi's economy since 2012 had sizable spillover effects on the financial system.** The 2012 devaluation of the kwacha impacted the balance sheet of banks. Inadequate fiscal adjustment following the "cashgate" scandal contributed to fiscal imbalances that were transmitted to the private sector directly through the accumulation of domestic payment arrears and indirectly through higher interest rates and greater exchange rate volatility associated with policy uncertainty. Higher interest rates, reflecting the inflation premium, increased credit and market risks, and contributed to a trebling of non-performing loans (NPLs) of banks to about 15 percent since mid-2012 and net interest margins that are significantly higher than those of neighboring countries (Figures 3 and 4). Weak economic activity has meant that some companies have experienced difficulties in remitting contributions to pension funds. Similarly, some insurance companies have reported arrears in collection of rental income from government. At a granular level a number of banks face a high degree of concentration risk, reflecting in part the limited number of large creditworthy customers. The RBM reduced vulnerabilities by selling two weak banks with significant state-shareholding, which are being recapitalized.

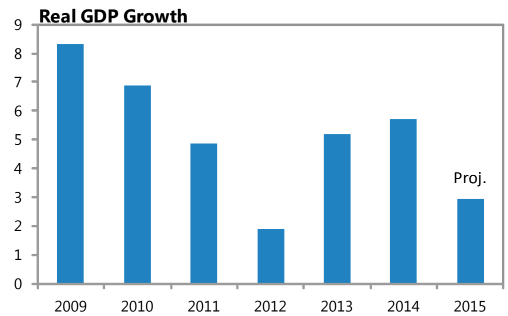
Text Figure 4. Policy, Interbank and Treasury Bill Interest Rates (Jan.2014–Oct.2015)



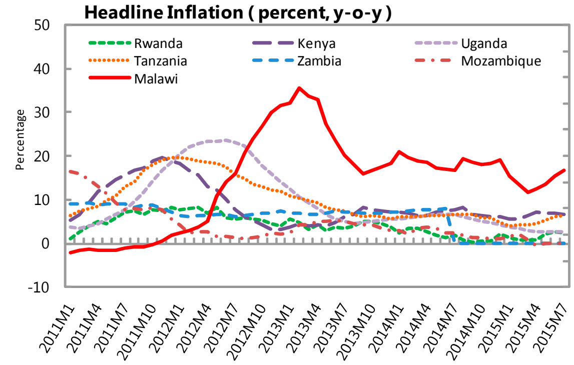
Source: Malawian authorities' Data.

Figure 1. Malawi: Recent Developments, 2009–15

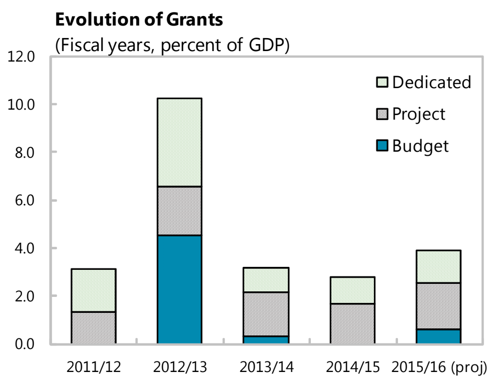
Economic activity in 2015 is being impacted by adverse weather…



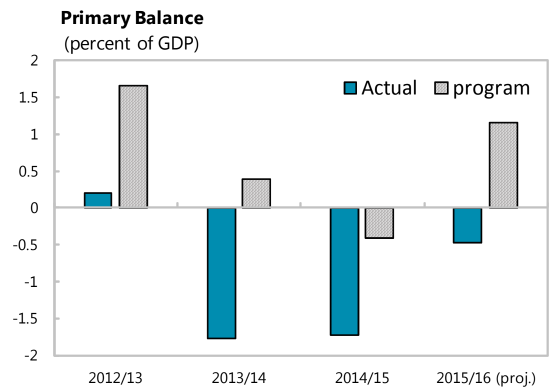
… while headline inflation remains stubbornly high compared to neighboring countries.



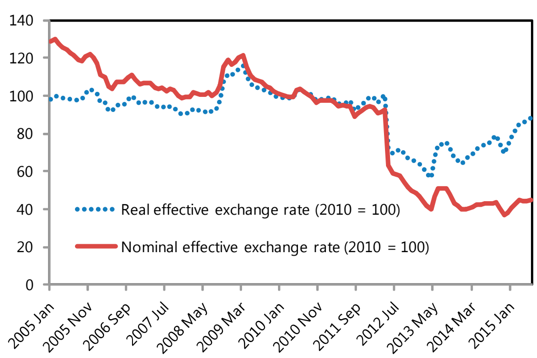
Shortfalls in external aid emerged due to the public funds misappropriation scandal.



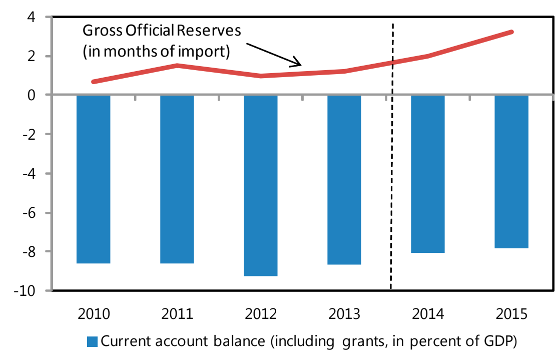
Fiscal adjustment was insufficient.



The REER appreciated, reflecting higher domestic inflation relative to trading partners.

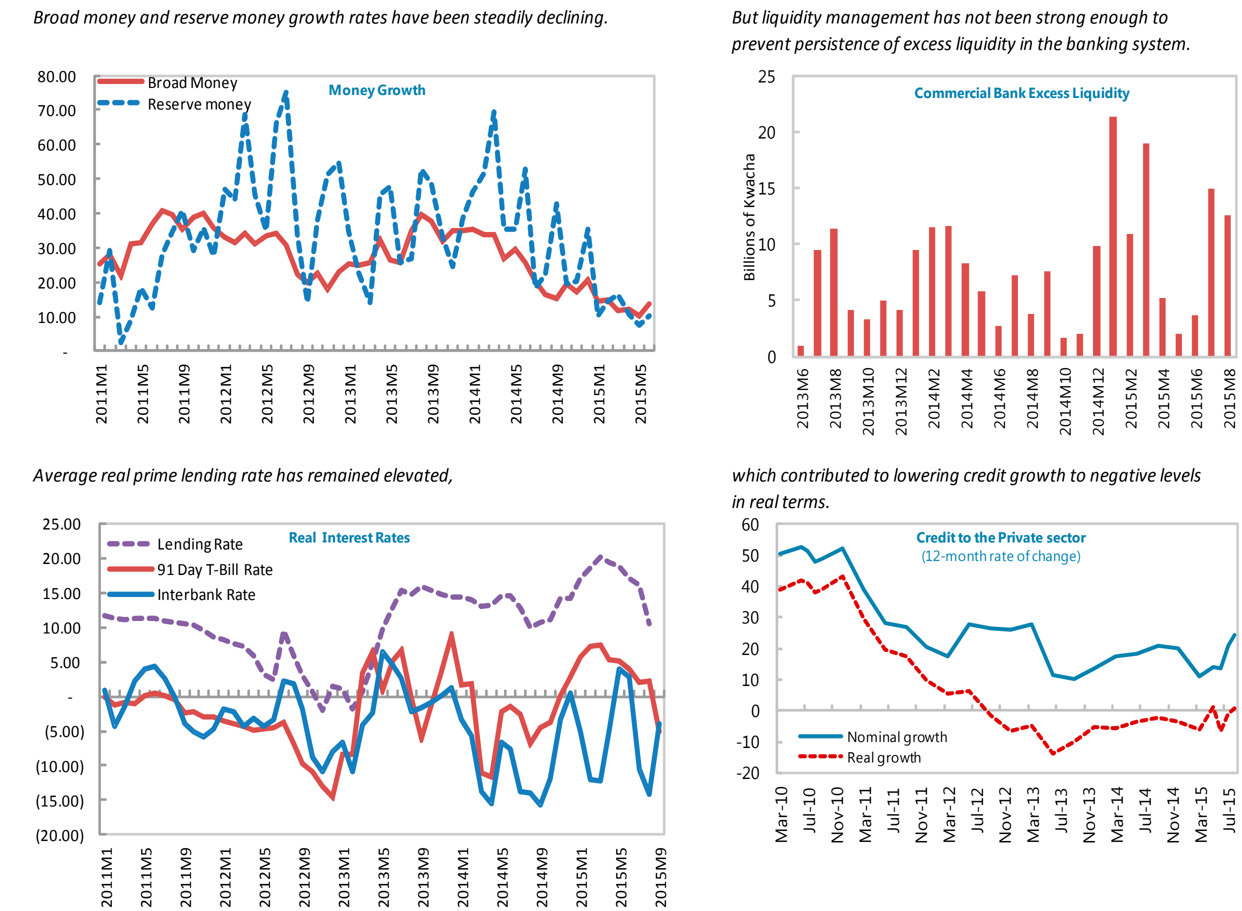


The current account narrowed reflecting weak aggregate demand.



Sources: Malawian authorities and IMF staff estimates.

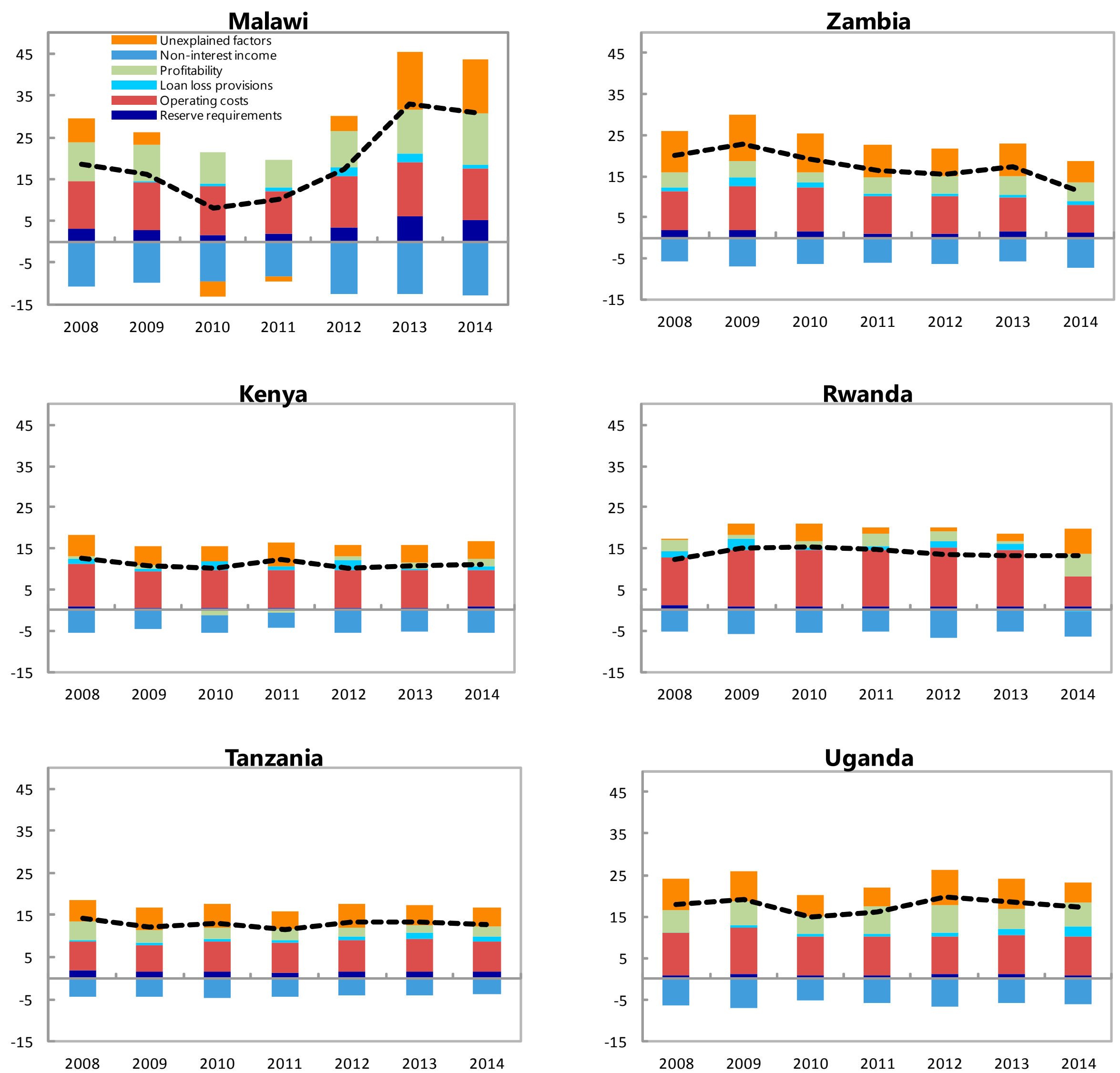
Figure 2. Malawi: Recent Monetary Developments



Sources: Malawian authorities' data and IMF staff estimates.

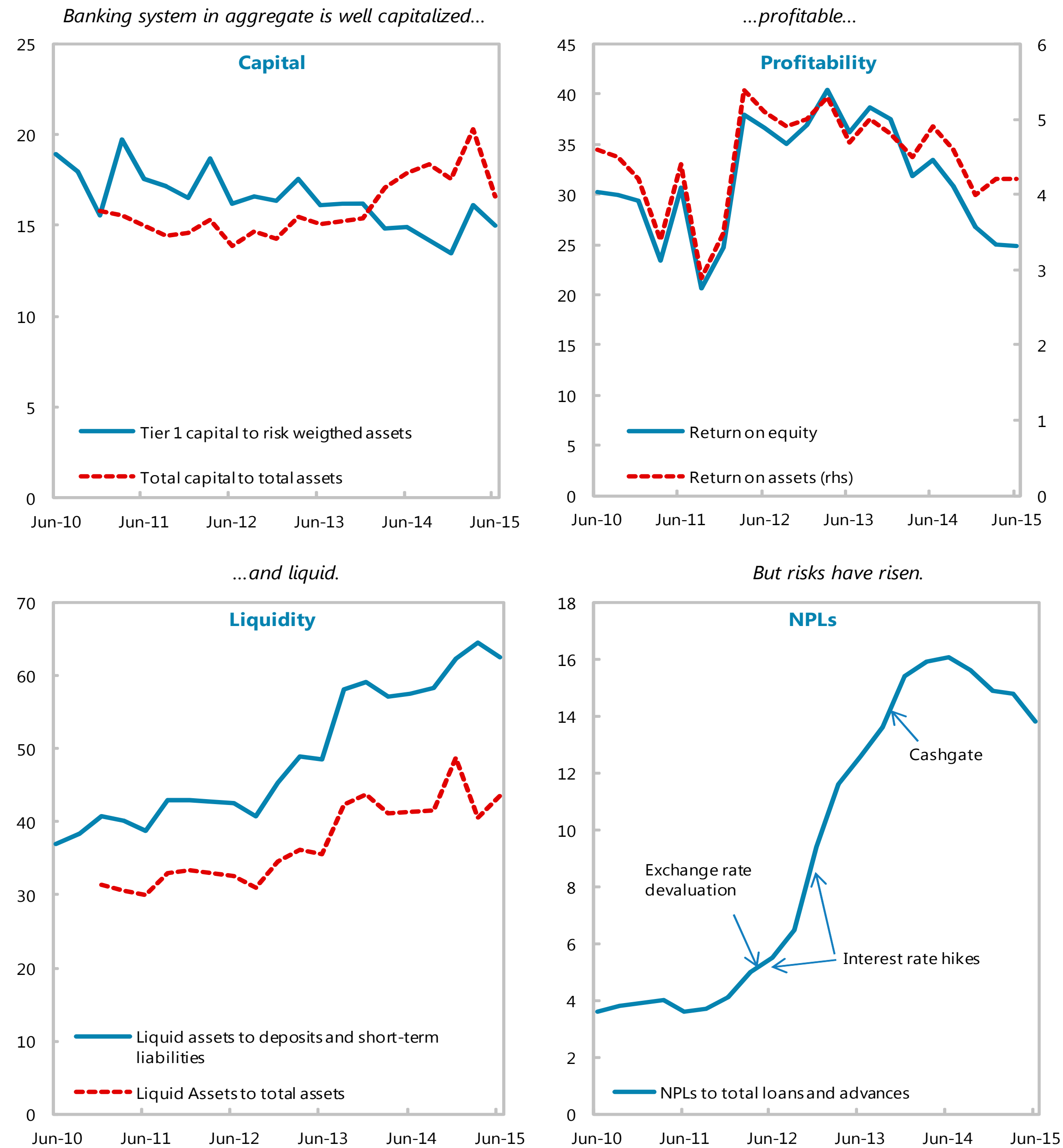
Figure 3. Malawi: Comparisons of Net Interest Margins with Peer Countries, 2005–14

Net interest margins are double those of neighboring countries, reflecting credit and market risk and the inflation premium.



Source: BankScope.

Figure 4. Malawi: Selected Financial Stability Indicators, 2010–15



Source: Reserve Bank of Malawi.

ECONOMIC OUTLOOK AND RISKS

9. **The economic outlook remains challenging in light of continued uncertainties related to weather conditions, the resumption of budget support, and macroeconomic instability stemming from persistently high inflation.** The medium-term projections are predicated on policy actions to reduce inflation, limited budget support (½ percent of GDP in FY15/16) pending full donor re-engagement, a normalization of weather conditions, and implementation of the structural reform agenda.

- **Growth** is expected to pick up to 4.5 percent in 2016, rising to about 5½ percent over the medium term (within the range of the average over the last 10 years), conditional on a recovery in the agricultural sector, construction activity, and the wholesale and retail sectors. Credit to the private sector is projected to pick up over the medium term as inflation falls to single digits.

- **Inflation** is projected to be higher than expected due to the supply shock and the lagged effects of looser-than-expected macroeconomic policies. Inflation is expected to ease in 2016 as the policy stance tightens and will be facilitated by lower international prices for food and petroleum products.

- **The external current account** deficit will remain in the 8 percent range over the medium term reflecting the demand for imports associated with developmental projects and rapid population growth, and the slow pace of export diversification.

- **Short-term risks** are tilted to the downside as the looming food crisis—the worst in the last 10 years—continues to weigh heavily on the outlook. Additional downside risks could arise from lower global demand or continued slippages in macroeconomic policy implementation that could place further pressure on the kwacha, dampen financial inflows, and reduce demand for Malawi's exports. The "El Niño" weather phenomenon—the worst in the last 35 years—could adversely affect regional maize harvests.

Text Table 2. Macroeconomic Outlook

	2014	2015	2016	2017	2018
	Est.		Proj.		
GDP at constant market prices	5.7	3.0	4.5	5.2	5.5
Consumer prices (annual average)	23.8	21.9	19.8	11.8	8.8
Overall balance (including grants), on a fiscal year basis	-6.1	-5.7	-3.8	-2.5	-2.8
Credit to the private sector (percent change)	20.0	15.1	16.5	18.6	19.5
Gross official reserves (months of imports)	3.2	3.6	3.6	3.7	3.7
Current account (percent of GDP)	-8.1	-7.9	-7.8	-7.8	-7.7
Total public debt (percent of GDP)	41.5	48.0	45.1	42.3	41.4

Sources: Malawian authorities' data and IMF staff projections.

Authorities' views

10. **The authorities agreed with staff's views on the outlook** and noted that should some of these risks materialize, there would be limited fiscal space for countercyclical policies. However, the

flexible exchange rate and automatic fuel pricing mechanism should serve as shock absorbers in mitigating global spillovers (Annex II).

POLICY DISCUSSIONS

11. Policy discussions centered on measures to restore macroeconomic stability, re-establish confidence in policy implementation and PFM systems, and address key medium-term challenges.

- **Near-term** priorities consist of (i) restoring macroeconomic stability by implementing tight fiscal and monetary policies needed to place inflation on a declining trajectory; and (ii) accelerating the implementation of priority PFM reforms to re-establish trust and confidence in the budget process.

- **Over the medium term,** policies should concentrate on safeguarding macroeconomic stability, consolidating PFM and debt management reforms, improving the quality of spending, promoting higher and inclusive growth, and reducing macroeconomic risks that spill over to the real and financial sectors. Given large balance of payments and infrastructure needs, donor re-engagement and revenue mobilization are critical to the achievement of these medium-term objectives.

A. Key Priorities in the Near Term

Restoring Macroeconomic Stability

12. An appropriately tight fiscal policy is needed to support monetary policy actions aimed at placing inflation on a downward trajectory. The sudden stop in donor budget support in 2013 opened up a large financing gap, which as a result of inadequate fiscal adjustment has been filled through increased recourse to domestic financing (cumulative 7½ percent of GDP in FY13/14 and FY15/16). In particular, increases in the wage bill granted in FY14/15 in the absence of sufficient offsetting measures have fueled the private sector's perception that adherence to budget targets is problematic and that domestic financing of the fiscal deficit will persist. This has had a detrimental impact on growth as it fueled uncertainty and stymied investment.

13. The pending adoption of a revised budget for fiscal year 2015/16 will constitute a critical first step in restoring macroeconomic stability, given the changed macroeconomic outlook. The sharp changes in the macroeconomic setting (¶5) and the carryover effects from fiscal slippages (¶6) created a financing gap of about one percent of GDP in the FY15/16 budget. The revised budget is based on realistic revenue estimates and proposes cuts in domestically financed investment and goods and services while limiting net domestic financing (¾ percent of GDP). The revised fiscal framework takes into account donors' financial assurances and safeguards social spending. Safeguarding social spending is critical to consolidate recent achievements in improving the delivery of public services in health and education (Box 2).

14. A tight monetary policy is needed to achieve positive short-term real interest rates. Prior to the change in the LRR, monetary policy had borne the brunt of the adjustment of the disinflation effort (¶7). However, since then, the pursuit of the competing objectives of disinflation and stimulating real sector activity by lowering prime lending rates resulted in an increase in liquidity in the banking system. Looking ahead, the RBM has sufficient instruments to conduct effective liquidity management provided fiscal policy is supportive. A clear communication of its monetary policy stance to market participants will contribute to improved policy credibility and in anchoring inflation expectations. Moreover, the RBM should closely monitor all forms of lending to the government to remain within the limits fixed by the recently enacted amendments to the Central Bank Act.

Box 2. Social Sector Progress

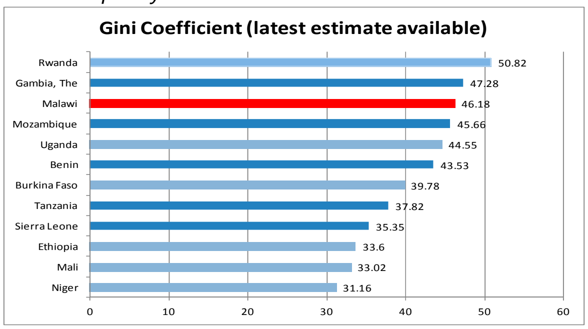
Initiatives to address gender disparity in education have borne fruit. Gender parity in primary school enrollment has been achieved and female primary school completion rate has been above the average for SSA LICs since 2008. However, pressures of early marriage and teenage pregnancy continue to limit female retention at the secondary level.

Improvements in the delivery of health care services and higher allocations to the health sector contributed to a sharp reduction in infant mortality rates. Infant mortality is now significantly below the SSA LIC average and the 2015 MDG target is within reach. Life expectancy has also improved over time, but remains below the SSA average.

Access to electricity and water—key indicators of social welfare—has improved substantially. The implementation of a rural electrification program expanded the population centers connected to electricity from 45 in 2005 to 182 in 2010 and the proportion of the population with access to electricity has reached 9 percent since 2010. Access to improved water also rose from 72 percent in 2005 to 85 percent in 2012.

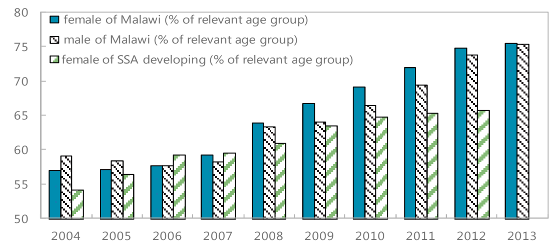
Box 2. Social Sector Progress (concluded)

Income inequality has become more acute since 2004…



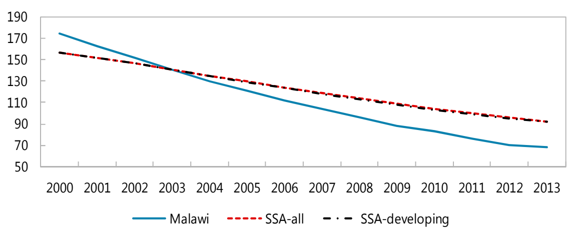
…while progress has been made on gender equality in education.

Primary completion rate: Malawi vs SSA LICs, 2004~2013



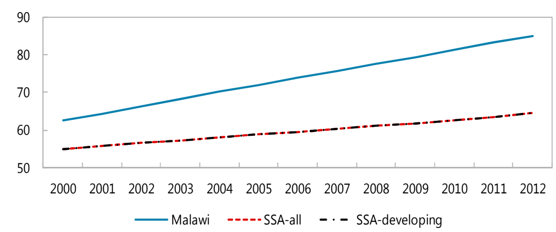
Infant mortality has dropped below the SSA LIC average since 2004.

Mortality rate of age 5- :Malawi vs SSA developing vs SSA, (per 1,000 live births)



Access to improved water has been consistently above the SSA average.

Improved water source: Malawi vs SSA developing vs SSA, (% of population with access)



Source: World Bank WDI.

Note: The primary completion rate for the female of SSA LICs in 2013 is not available.

Authorities' views

15. **The authorities considered that the uptick in inflation in 2015 was predominantly due to supply shocks but recognized that fiscal retrenchment was necessary for disinflation.** In order to tame inflation, they noted that further domestic borrowing in FY15/16 should be limited and that high real lending rates had choked off demand for credit.

Accelerating the Implementation of Priority PFM Reforms

16. **Progress in implementing priority PFM reforms has been slow and efforts need to be redoubled.** Although the sequencing and implementation of key reforms were supported through IMF technical assistance (TA), bank reconciliations have not been successfully completed and weakness in cash management and financial reporting has persisted. Nevertheless, some initiatives aimed at improving the performance of the Integrated Financial Management System (IFMIS) and strengthening the budgetary process have been undertaken (Box 3). Staff stressed that bank reconciliations were critical to identifying and preventing the potential misappropriation of public funds and therefore to reviving donor re-engagement. In addition, stronger commitment control will mitigate the emergence of domestic payment arrears and permit domestic financing to be limited to budgeted amounts. In this regard, there is need for regular oversight, accountability and the

application of sanctions on public sector officials in accordance with the PFM Act, if they fail to carry out their responsibilities.

Authorities' views

17. The authorities underscored that some progress was made on the PFM front (Box 3). However, they recognized that major challenges remained in areas of financial reporting and bank reconciliations due to the huge backlog of transactions. In order to address this issue, a taskforce comprising of the accountant general and RBM's staff is meeting weekly to validate and clear the backlog. A high-level committee chaired jointly by the Secretary to the Treasury and the RBM's Governor is scheduled to meet monthly to review progress and facilitate the reconciliation process.

Box 3. Recent Achievements in PFM Reforms

Progress has been made in rationalizing the government bank accounts at the RBM. 139 dormant bank accounts at RBM have been closed and their balances transferred to government's main operating account (MG1). An additional 265 dormant bank accounts at RBM have been submitted to the accountant general for review.

Concrete actions have been taken to increase the coverage of IFMIS. The main government bank accounts have been incorporated into the IFMIS and the backlog of all transactional data for 2014/15 has been captured. Payments of budgeted expenditure that are generated outside of the IFMIS have also been reduced. The ultimate goal is to integrate all bank accounts into the IFMIS to improve the accounting and control of public resources.

Hardware and network upgrades have helped enhance the reliability of the IFMIS.
The procurement of additional servers and the network upgrade have increased processing speed and reduced downtime. These upgrades will help accelerate bank reconciliations. An IFMIS security officer has been appointed to manage the security of the system and provide security training.

Controlling Officers have been explicitly charged with improving financial discipline within spending units. Mandated actions include ensuring that commitments and payments do not exceed the released funds; providing cash flow forecasts; performing timely bank reconciliations; submitting the annual financial statements in a timely manner for audit; and certifying monthly financial statements.

Additional initiatives are being taken to foster budget control and transparency. The authorities have instituted independent audit committees, responsible for reviewing audit matters presented by internal and external auditors. In addition, the authorities are in the process of introducing treasury inspectors in ministries to oversee budget planning, monitoring and evaluation.

B. Key Priorities Over the Medium Term

Ensuring Medium-Term Fiscal Sustainability

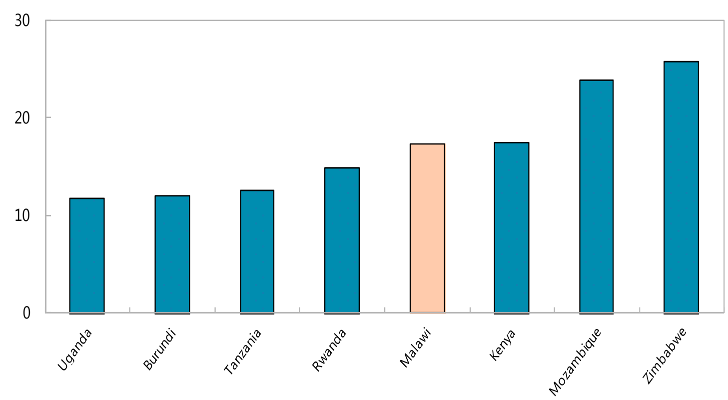
18. The pursuit of prudent fiscal policy is indispensable to safeguarding medium-term fiscal and debt sustainability. To this end the medium-term fiscal anchor comprises a primary fiscal balance that places domestic debt on a gradual declining path and limits non-concessional borrowing given weaknesses in debt management capacity. The overall deficit would decline from a peak of about 6 percent of GDP in FY14/15 to 2.5 percent of GDP in FY18/19.

19. Improving the allocation of public spending will create fiscal space and safeguard the provision of critical social spending (Figure 5). Currently, there is limited fiscal space as the wage bill, interest payments, pensions, and outlays on the farm input subsidy program (FISP) account for about 75 percent of domestic revenues in FY14/15. The wage bill (35 percent of revenues) has contributed to a worsening in expenditure rigidities and the crowding out of domestically financed capital spending. In an effort to contain the wage bill, the authorities are conducting a comprehensive payroll audit to eliminate ghost workers. Travel allowances, which have been overly generous, were cut by more than 25 percent in FY15/16 budget relative to the previous year.

20. The authorities' efforts to review the FISP (Selected Issues) are welcome given the need for fiscal consolidation. In an effort to create fiscal space and increase expenditure efficiency, the authorities intend to lower the subsidy rate from 97 percent to 79 percent and reduce procurement costs. Staff developed a model with sectoral interlinkages to analyze the distributional effects of the reform. While the reform would yield about one percent of GDP in savings, it would reduce pro-poor spending and adversely impact income inequality. In order to mitigate the negative impacts on the poor, staff recommended using part of the savings to increase cash transfers which would boost growth and reduce inequality. Net savings would be in the range of 0.3–0.5 percent of GDP.

21. Greater revenue mobilization is needed to respond to the rising demand for public services from a rapidly growing population and to meet Malawi's sustainable development goals. Malawi's revenue-to-GDP ratio remains above those of a few neighboring countries, even after the rebasing of GDP. However, given uncertainties surrounding the resumption of budget support, the authorities should aim to increase domestic revenues (1–1½ percent of GDP) over the medium term to fully cover current spending. This will require strengthening VAT compliance, increasing audits of large taxpayers, broadening the tax base (telecoms, mining, and property taxes), and modernizing tax administration through increased computerization.

Text Figure 5. Tax Revenue Compared to Neighboring Countries (Percent of GDP, 2014)

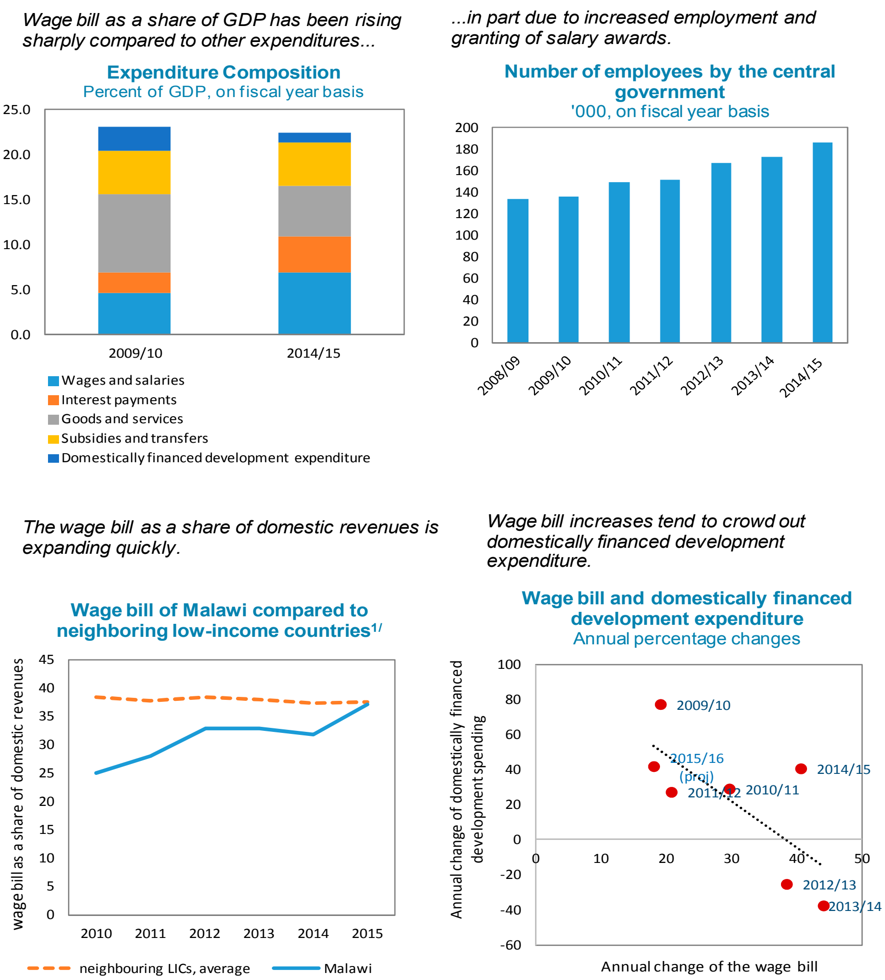


Sources: World Economic Outlook, Malawian authorities' data and IMF staff estimates.

22. Fully funding the public sector pension scheme—one of the objectives of the 2011 pension reform—is fiscally untenable and should be revisited. Servicing benefits accrued under the existing non-contributory defined benefit pension scheme requires disproportionately high budget subsidies. Meeting these accrued liabilities would require assets exceeding 60 percent of

GDP which would undermine fiscal sustainability and a debt issuance of such magnitude could not be accommodated by Malawi's capital markets. Reforms should concentrate on reducing the liabilities of the current system by adjusting its parameters in line with recommendations from IMF technical assistance.

Figure 5. Malawi: Development of Wage Bill



Sources: World Economic Outlook, Malawian authorities' data and IMF staff estimates.

[1/] Low income countries included in the computation of wage bill average are Burundi, Kenya, Mozambique, Rwanda, Tanzania, Uganda and Zimbabwe. Data for Malawi is reported on fiscal year, which runs from July to June next year, e.g. fiscal year 2015 runs from July 2014 to June 2015.

Authorities' views

23. **The authorities agreed with staff on the need to improve the efficiency of government spending and mobilize revenues.** They underscored that the payroll audit, containing the travel budget and reforms to the FISP were key measures to this end. On the revenue front, identifying new sources of revenues, strengthening compliance, and migrating to a computerized tax administration were key medium-term reforms.

Preserving Debt Sustainability

24. External debt remains at moderate risk of distress. A staff update on debt sustainability concluded that the public and publicly guaranteed external debt-to-GDP ratio in net present value (NPV) terms is expected to follow a declining trend, just as envisioned in the previous WB/IMF DSA (March 2015). GDP was recently rebased, which pushed some debt indicators (including the baseline scenario debt-to-GDP ratio) below thresholds. External debt would evolve as expected in the previous DSA. A debt monitoring committee has been established to oversee the debt management process and identify risks associated with rapid debt accumulation and vulnerabilities to external shocks.

Improving the Conduct of Monetary Policy and Commitment to the Flexible Exchange Rate Regime

25. There is scope to improve Malawi's monetary policy architecture and to increase the RBM's capacity to fight inflation. Price stability should be the primary objective of monetary policy over the medium term in order to prevent tensions in meeting competing objectives. Currently the RBM operates a reserve money program but is also mindful of the potential impact of interest rate policy on aggregate demand. In this context the policy rate is publicly announced to convey its policy stance. However, building policy credibility requires the active use of open market operations in order to align short-term market determined rates with the policy rate. Staff noted that large and frequent differences between the *de facto* policy stance (represented by short-term money market rates) and the policy rate undermine the credibility of monetary policy and weakens the monetary transmission mechanism.

26. Staff underscored the need to further improve the monetary policy framework to support financial market development and enhance intermediation. Strengthening the RBM's capacity to forecast economic activity and inflation would help monetary policy become more forward-looking. To increase the use of indirect instruments and interest rates to signal the monetary policy stance, the RBM needs to strengthen its ability to forecast and actively manage liquidity. A more active management of short-term liquidity in the banking system is a prerequisite for developing the interbank market and, improving monetary transmission mechanisms.

27. The flexible exchange rate regime has served Malawi well in addressing structural balance of payments problems. The real effective exchange rate has depreciated over long periods through end-2013. Despite a real appreciation in 2014 by 8 percent, staff's assessment suggests that the real exchange rate is broadly in line with fundamentals at end-2014 (Annex III). Nevertheless, there is scope to improve competitiveness through the implementation of structural reforms and to increase reserve cover given Malawi's susceptibility to large external shocks. Staff found that the authorities' practice of determining the exchange rate of commercial banks through moral suasion has ceased, thereby removing the official action that gave rise to the multiple currency practice identified in August 2006 and manifested by the significant spread between the commercial bank and foreign exchange bureau rates. Staff urged the authorities' to review and amend the recent foreign currency directives especially those provisions that potentially impede price discovery and the functioning of the foreign exchange market.

Authorities' views

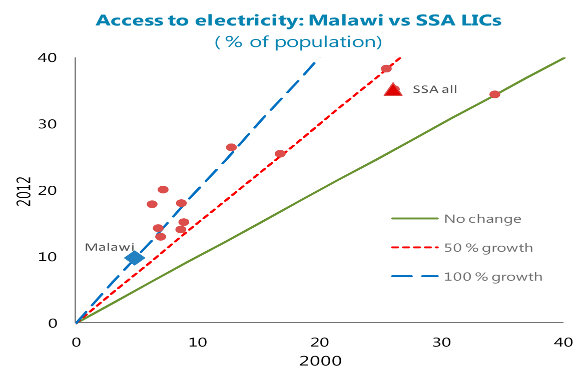
28. The authorities agreed with staff's assessment of the level of the exchange rate. They indicated their commitment to allow the exchange rate to be market determined and stressed that, going forward they intend to conduct only limited foreign exchange interventions to dampen bouts of market volatility.

29. Regarding the monetary policy architecture, the RBM noted that treasury bill rates are determined by supply and demand and that aligning the policy rate with treasury bills rates is not a daily operational objective. They maintained that, given the oligopolistic structure of the interbank market, the interbank rate had no relationship with the policy rate or government paper beyond 90 day maturities. In their view, the fiscal costs of aligning the interbank rate with the policy rate outweighed the monetary policy benefits and could not be justified as a daily operational objective. However, as inflation decelerates, they foresaw the possibility of moving in this direction.

Promoting Higher and Sustained Growth

30. Inadequate infrastructure and low productivity in agriculture remain key structural weaknesses hampering the growth lift off. Critical supply-side bottlenecks include the availability and reliability of electricity and water supply, transportation costs, the quality of feeder roads, and the cost and access to credit. Agriculture will remain the engine of growth but the sector remains highly vulnerable to climatic shocks and its productivity is undermined by the low level of irrigation, high transport costs along the value chain, insufficient extension services, and limited access to credit. The recently completed railway linking Malawi to the Mozambican coast augurs well for lowering transportation costs for exports.

Text Figure 6. Electricity in Malawi



Source: IMF staff estimates.

31. Reliability of fuel supply and the automatic fuel pricing mechanism are critical to fostering growth. To this end, there is need to clarify the fuel import regime among the regulator, state, and private suppliers of petroleum products to avoid supply disruption. If the reform includes a greater role for the state-owned oil company, there will be a need for a governance structure that safeguards transparency in order to mitigate the emergence of contingent liabilities to the government.

32. Efforts to improve Malawi's business environment remain crucial to unlocking growth. While staff's assessment of the level of the exchange rate is in line with fundamentals, non-price factors continue to hamper competitiveness. Malawi's rankings in the World Bank's Doing Business Indicators and World Economic Forum's Global Competitiveness Report have both undergone a continuous deterioration. Firms identify access to financing, corruption, crime and theft, tax rates, and inflation, as the five major constraints to doing business in Malawi (Figure 6).

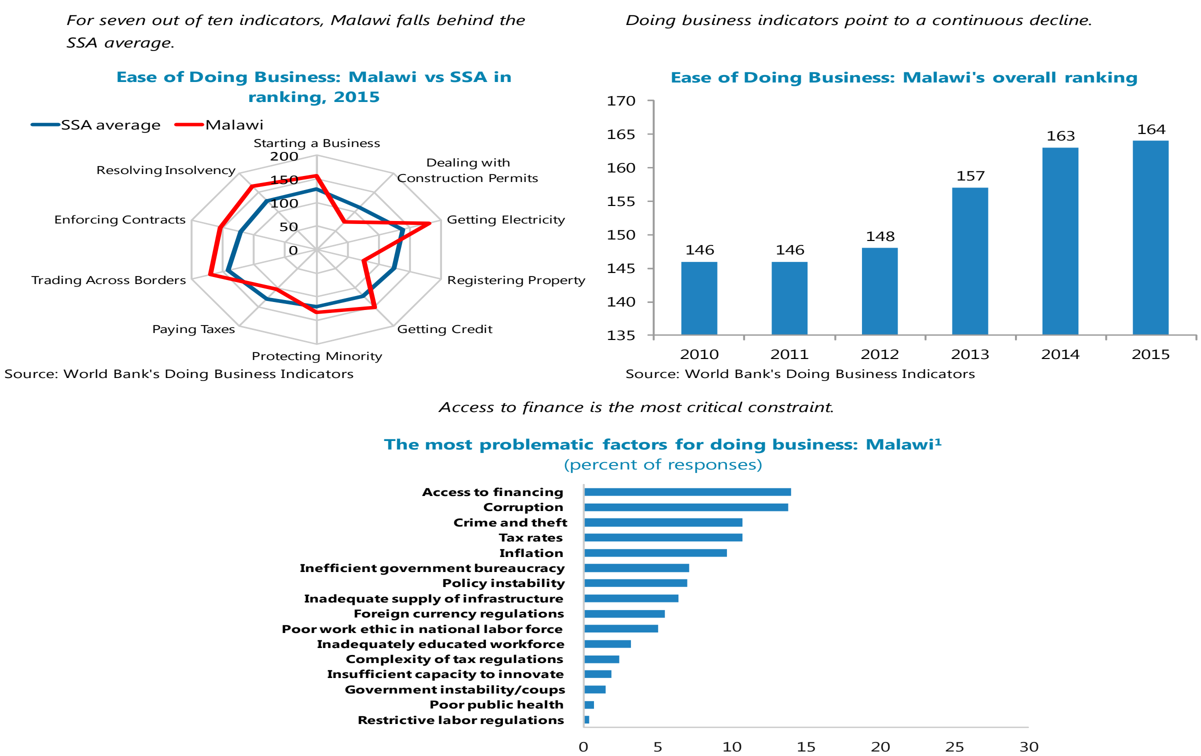
Authorities' views

33. The authorities agreed with staff's assessment. They also noted that macroeconomic stability was important for the development of capital markets and that improved supervision of the non-bank sector will strengthen the resilience of financial markets.

Economic Statistics

34. Although the provision of economic data has some shortcomings, it is broadly adequate for surveillance. There is scope to improve the coverage of the financial accounts of the balance of payments, and the consistency of source data in government financial statistics.
In addition, more detailed monthly CPI data could serve as an important input to monetary policy formulation (Information Annex).

Figure 6. Malawi Business Environment



Source: The Global Competitiveness Report 2015–16.

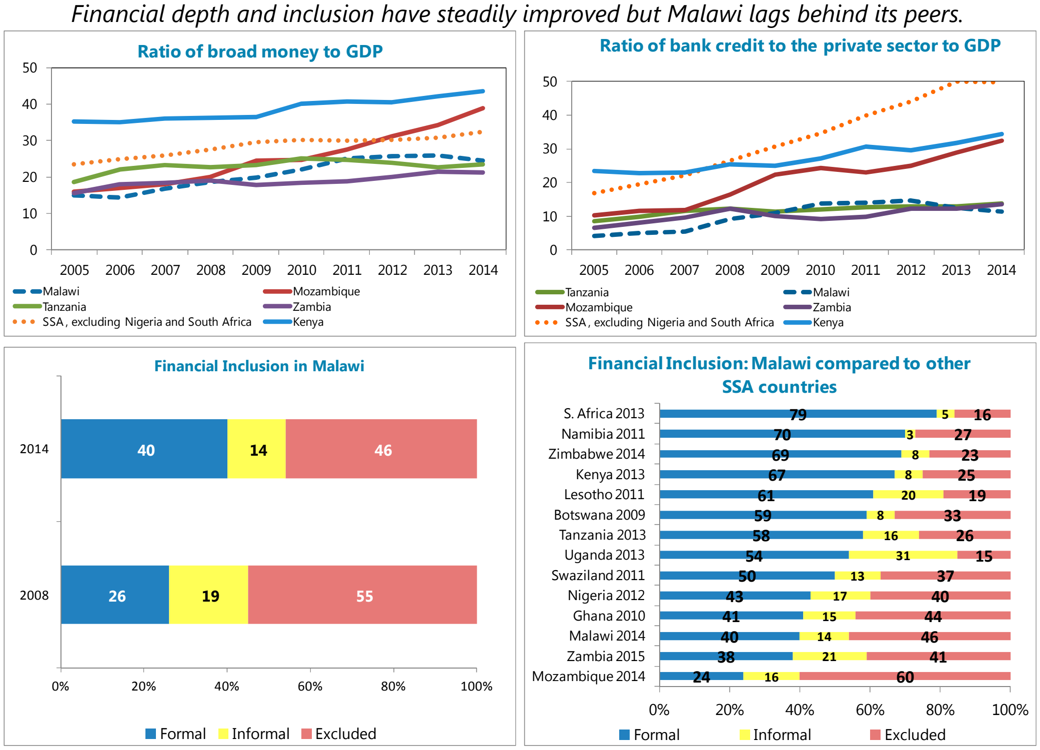
[1]From the list of factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

C. Enhancing Financial Stability and the Role of the Financial Sector in Fostering Inclusion and Growth

35. Macroeconomic risks comprise an important source of spillovers to the financial sector with feedback loops to the fiscal and real sectors. These spillovers arise from policy slippages related to inadequate fiscal adjustment that lead to the accumulation of domestic payment arrears to private suppliers who experience difficulties in servicing loans, leading to higher NPLs. Increased recourse to domestic financing crowds out the private sector, increases banks' and non-banks' exposures to government and creates economic uncertainty.[3] Volatile tobacco exports receipts—the main export earner—and erratic maize harvests, are other sources of risks with negative effects on banks' and firms' balance sheets that are amplified by exchange rate volatility. Feedback to the fiscal and real sectors arises via higher interest costs.

Figure 7. Malawi: Financial Deepening and Inclusion

Financial depth and inclusion have steadily improved but Malawi lags behind its peers.



Sources: Malawian Authorities' data, IMF staff estimates and FinScope.

36. Financial sector depth and inclusion have increased steadily through 2012, but have since stagnated in the face of persistently high inflation (Figure 7). Standard metrics of financial

[3] At end-2014 government securities comprised 24 percent of banks' assets.

sector depth point to substantial improvement but Malawi has lagged behind its peers. Real GDP growth in recent years has been driven mainly by rain-fed agriculture and services which accounted for 45 percent of bank credit. Access to formal financial services increased from 26 percent of adults in 2008 to 40 percent in 2014, but remains concentrated in urban areas while 50 percent of adult population in rural areas remain un-served. Despite improvements in financial inclusion, Malawi compares poorly relative to peers, underscoring the need to restore macroeconomic stability, improve financial infrastructure, and foster greater financial literacy.

37. Stress tests confirmed that credit risk stemming from high exposure to large borrowers poses a significant threat to the banking system (Box 4; Selected Issues). Globally, the banking system would be resilient to an increase in NPLs as well as liquidity and market risks. Specifically, concentration risk arising from exposure to large borrowers represents the largest source of credit risk. In addition, the system is not robust to a combined major shock to net interest and foreign exchange income which would lower the tier 1 capital ratio below the norm of 10 percent.

38. As the economy continues to face strong headwinds, continuous vigilance is warranted to ensure appropriate and timely responses to potential adverse developments in the financial sector and to minimize their economic and fiscal costs. Against this background, there is need for continued stress testing, enhancing supervision, and enforcing compliance with prudential norms. Strengthening creditor rights and reducing lengthy judicial processes in recovering collateral are critical to the reduction of NPLs. The introduction of new provisioning directives is a welcomed step in addressing low provisioning rates. Given the economy is prone to large shocks, concentration risk linked to exposure to large borrowers and its implications for liquidity, requires crisis contingency planning, and strengthening the resolution framework for financial institutions in order to minimize costs in the event of insolvency.

Authorities' views

39. The authorities agreed that a sound banking system and restoring macroeconomic stability were critical to fostering financial inclusion. The authorities recognized that credit risk and particularly concentration risk from exposure to large borrowers remain the largest threat to financial sector stability. They underscored, however, that concentration risk will remain a feature of the financial system given the role of large conglomerates in the economy and limited access to both long-term external and domestic financing. They noted that going forward, higher capital requirements, improving credit assessments, higher provisioning, and bank mergers were key to mitigating these risks.

Box 4. Banking Sector Stress Tests

The RBM's stress testing framework, draws on the Cihak (2007) model and considers four categories of risks, namely credit, liquidity, market (interest and foreign exchange risks), and income risks. The results are published semi-annually. For each risk, the impact of minor, moderate, and major shocks on bank's capital adequacy is tested. IMF staff in collaboration with RBM staff conducted stress tests covering the above risks but modified by a stronger assumption on provisioning for new NPLs. The results are summarized below:

On credit risk:

- The banking system is resilient to a moderate shock that increases NPLs uniformly across banks. A major shock would push four banks and the whole banking system below the tier 1 capital adequacy ratio (CAR).
- The banking system is also resilient to differentiated sectoral increases in NPLs even in the case of a major shock doubling NPLs in the five key sectors.
- Banks are highly exposed to concentration risk. The aggregate tier 1 CAR would fall below the benchmark of 10 percent following a default of the first largest borrower in each bank. Ten out the eleven banks will fall below the prudential capital requirement in case of default by their first two largest borrowers.

On liquidity risk:

- Banks are largely resilient to liquidity risks. However, the survival period of all banks would be less than one week in case of a major deposit run.

On market risks:

- In aggregate, banks are resilient to interest rate and foreign exchange risks. A major foreign exchange shock, however, would leave two banks with a tier 1 CAR below the current prudential standard.

On income risk:

- Banks were found to be quite sensitive to a combined shift in net interest income and foreign currency income. The system's tier 1 CAR would fall below 10 percent norm in the event of a major shock and the tier 1 capital ratios of three banks would fall below the prudential norm in case of a minor shock.

STAFF APPRAISAL

40. Policy slippages and adverse shocks have so far prevented Malawi's achievement of sustained growth and low inflation under the authorities' growth and development strategy. Growth remained below that of sub-Saharan Africa, while inflation persisted in double digits. Nevertheless, progress has been made in improving social indicators in health and education.

41. Restoring macroeconomic stability is the most critical near term priority. Given that inflation has been stuck above 20 percent since 2012, tighter fiscal policy is needed to support a monetary policy stance aimed at placing inflation on a downward trajectory. To this end, reducing inflation will necessitate the implementation of a credible budget in line with sustainable financing and a reprioritization of expenditures whilst safeguarding social spending. Low inflation is also a key to restoring private sector confidence, and to fostering growth and financial inclusion.

42. The accelerated implementation of PFM reforms is indispensable to restoring trust and confidence in the budget process. Greater commitment control that contains voted expenditures to available resources will mitigate the emergence of payment arrears and allow domestic financing to be limited to budgeted amounts. The completion of bank reconciliations and the restoration of basic fiscal reporting are critical to fostering donor re-engagement in light of Malawi's structural external sector weaknesses.

43. Greater revenue mobilization is key to reducing aid dependency, mitigating policy slippages, and the pursuit of Malawi's sustainable development goals. In this regard, the authorities are encouraged to increase collections from new revenue sources, strengthen compliance, and to modernize their tax administration.

44. Improving expenditure efficiency will create fiscal space, and safeguard previous quick wins in health and education. The authorities are commended for initiating reforms to the farm input subsidy program which is ill-targeted, and implementing a payroll audit to eliminate ghost workers. The authorities should raise cash transfers to reduce the adverse impacts of the subsidy reform on the poor.

45. Pension reforms should be revisited in order to safeguard fiscal sustainability. This is underscored by the sizable accrued liabilities and the inability of the capital markets to absorb a large influx of savings.

46. The flexible exchange rate regime and the automatic fuel pricing mechanism have served Malawi well in addressing structural weaknesses in its balance of payments. Staff cautions that any changes to the fuel import regime should be fully transparent and include consultations with all stakeholders to avoid growth-damaging disruptions in supply.

47. Mitigating policy slippages—a major source of macroeconomic risks—would reduce spillovers to the real and financial sectors. Given recent shocks and the identification of concentration risk as the most important threat to financial sector stability, staff urges continuous vigilance to ensure appropriate and timely policy responses to minimize their economic and fiscal costs.

48. It is proposed that the next Article IV Consultation be held in accordance with Decision No. 14747, as amended.

Table 1. Malawi: Selected Economic Indicators, 2012–18
(with rebased nominal GDP)

	2012	2013	2014	2015	2016	2017	2018
	Act.	Act.	Est.		Proj.		
National accounts and prices (percent change, unless otherwise indicated)							
GDP at constant market prices	1.9	5.2	5.7	3.0	4.5	5.2	5.5
Nominal GDP (billions of Kwacha)	1,502	2,011	2,570	3,198	3,933	4,564	5,190
GDP deflator	17.7	27.3	20.9	20.8	17.7	10.3	7.8
Consumer prices (end of period)	34.6	23.5	24.2	25.4	13.6	9.3	8.2
Consumer prices (annual average)	21.3	28.3	23.8	21.9	19.8	11.8	8.8
Investment and savings (percent of GDP)							
National savings	2.8	4.0	3.9	4.9	5.1	5.2	5.4
Gross investment	12.1	12.7	12.0	12.8	12.9	13.0	13.1
Government	5.8	5.3	4.6	6.6	5.6	5.8	5.6
Private	6.3	7.4	7.5	6.2	7.3	7.2	7.5
Saving-investment balance	-9.3	-8.7	-8.1	-7.9	-7.8	-7.8	-7.7
Central government (percent of GDP on a fiscal year basis)[1]							
Revenue	18.7	27.5	22.8	21.4	22.4	22.2	22.5
Tax and nontax revenue	15.6	17.3	19.7	18.6	18.5	18.6	18.9
Grants	3.1	10.2	3.1	2.8	3.9	3.5	3.6
Expenditure and net lending	23.5	28.5	28.9	27.1	26.2	24.7	25.3
Overall balance (excluding grants)	-7.9	-11.2	-9.2	-8.5	-7.7	-6.1	-6.4
Overall balance (including grants)	-4.8	-1.0	-6.1	-5.7	-3.8	-2.5	-2.8
Foreign financing	1.1	1.9	2.0	2.5	3.1	2.2	2.8
Domestic financing	4.7	-0.1	4.2	3.3	0.7	0.3	0.1
Discrepancy	-1.1	-0.8	-0.1	0.0	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	22.9	35.1	20.7	31.8	21.3	14.8	16.4
Net foreign assets	9.3	26.5	20.6	23.8	15.0	5.9	9.0
Net domestic assets	13.6	8.6	0.1	8.0	6.3	8.8	7.5
Credit to the government	0.0	11.3	-5.9	2.3	-0.6	0.4	0.1
Credit to the private sector (percent change)	25.4	14.4	20.0	15.1	16.5	18.6	19.5
External sector (US$ millions, unless otherwise indicated)							
Exports (goods and services)	1,421	1,657	1,751	1,558	1,698	1,861	1,943.2
Imports (goods and services)	2,282	2,315	2,388	2,186	2,264	2,452	2,556.0
Gross official reserves	236	397	588	683	745	772	895.4
(months of imports)	1.2	2.0	3.2	3.6	3.6	3.7	3.7
(percent of reserve money)	69.1	108.3	130.3	143.8	146.9	142.3	150.8
Current account (percent of GDP)[2]	-9.3	-8.7	-8.1	-7.9	-7.8	-7.8	-7.7
Current account, excl. official transfers (percent of GDP)[2]	-12.3	-10.0	-8.1	-8.3	-8.0	-7.8	-7.6
Real effective exchange rate (percent change)	-17.9	-14.9	8.8	…	…	…	…
Overall balance (percent of GDP)	1.6	3.1	2.7	1.0	0.5	0.9	2.0
Terms of trade (percent change)	-2.6	1.1	1.5	11.1	-1.5	-3.0	-1.1
Debt stock and service (percent of GDP, unless otherwise indicated)							
External debt (public sector)	20.1	25.5	26.6	34.0	31.7	30.0	30.4
NPV of external debt (percent of exports)	53.3	77.3	102.7	117.2	103.6	89.2	84.9
Domestic public debt	13.8	19.8	14.9	14.0	13.4	12.4	11.1
Total public debt	33.8	45.3	41.5	48.0	45.1	42.3	41.4
External debt service (percent of exports)	1.4	1.7	4.2	9.5	11.4	9.5	4.9
External debt service (percent of revenue excl. grants)	2.1	2.8	6.6	12.4	16.3	13.6	7.2
91-day treasury bill rate (end of period)	20.0	32.3	26.9	…	…	…	…

Sources: Malawian authorities and IMF staff projections.

[1] The fiscal year starts in July and ends in June. The current financial year, 2015, runs from July 1, 2014 to June 30, 2015.

[2] Numbers reflect re-classification of project and dedicated grants from current account to capital account.

Table 2a. Malawi: Central Government Operations, 2012/13–2018/19
(Billions of Kwacha)

	2012/13	2013/14	2014/15	2015/16		2016/17	2017/18	2018/19
	Actual	Actual	Actual	Budget	Proj.	Proj.		
Revenue	472	511	610	763	792	936	1,092	1,244
Tax and nontax revenue	297	441	530	666	655	787	919	1,049
Tax Revenue	269	388	463	592	582	697	813	926
Taxes on income and profits	129	181	233	294	295	352	409	463
Taxes on goods and services	111	168	189	247	239	288	339	390
Taxes on international trade	33	41	46	61	58	70	82	96
Other taxes	-4	-2	-6	-10	-10	-13	-17	-23
Nontax revenue [1]	28	53	67	74	73	89	106	123
Grants	176	70	79	97	137	150	173	195
Budget support grants	78	7	0	7	21	0	0	0
Project grants	35	41	48	53	68	65	65	69
Dedicated grants	64	22	32	37	49	85	108	126
Expenditure and net lending	489	647	773	930	928	1,044	1,230	1,387
Current expenditure	385	547	620	704	686	812	943	1,067
Wages and salaries	97	140	197	229	233	274	312	345
Interest payments	33	98	115	125	118	131	155	159
Domestic	29	94	108	101	107	117	140	142
Foreign	4	4	7	24	11	13	15	17
Goods and services	144	176	158	193	180	229	268	327
Generic goods and services	60	65	78	73	69	89	104	129
Road Maintenance	7	8	9	22	21	25	32	48
Agricultural SWAp		9	0	6	6	7	8	10
Health SWAp	32	20	23	31	31	42	48	55
Education SWAp	22	19	23	22	21	27	32	36
National / local elections	1	11	1	1	1	1	2	2
PFEM		3	1	3	4	4	4	5
Statutory expenditures	6	7	8	6	5	6	6	7
National AIDS Commission	5	9	3	6	8	10	11	13
Maize purchases	3	14	5	15	9	10	12	14
Rural Electrification Program	8	10	6	6	6	7	8	9
Subsidies and other current transfers	98	125	139	157	155	178	208	235
Pension and gratuities	16	20	31	43	43	52	59	70
Transfers to road and revenue authorities	8	13	14	15	17	17	24	24
Transfers to public entities and households	22	32	39	57	52	58	67	75
Fertilizer and seed subsidy	52	60	55	42	43	51	58	66
Arrears payments	12	8	11	0	0	0	0	0
Development expenditure	104	100	152	224	241	230	285	318
Foreign financed	72	81	124	174	201	181	229	247
Domestically financed	32	20	28	50	39	49	56	72
Net lending	0	0	1	2	1	1	1	2
Overall balance (including grants)	-16	-136	-163	-166	-135	-107	-138	-142
Discrepancy	-14	-2	-1	0	0	0	0	0
Overall balance (incl. grants and discrepancy)	-30	-138	-164	-166	-135	-107	-138	-142
Total financing (net)	30	138	164	138	135	107	138	142
Foreign financing (net)	33	45	70	113	110	93	135	142
Borrowing	38	54	82	131	132	116	164	176
Budget support loans	0	14	0	23	0	0	0	0
Project loans	38	40	61	99	121	116	164	176
Other external loans [2]	0	0	20	10	12	0	0	0
Amortization	-5	-9	-12	-18	-22	-24	-29	-34
Privatization proceeds	0	0	0	0	12	0	0	0
Net domestic financing	-2	93	94	25	13	15	3	0
Financing gap	0	0	0	28	0	0	0	0
Memorandum items:								
Domestic fiscal balance [3]	-120	-126	-118	-88	-70	-74	-81	-89
New securitized arrears	---	39	17	48	---	---	---	---
Nominal GDP	1,717	2,242	2,846		3,537	4,224	4,853	5,495

Sources: Malawi Ministry of Finance and IMF staff projections.

[1]Nontax revenues in 2013/14 and 2014/15 include the RBM profit transfer to government of MK19.2 billion and MK25.4 billion, respectively.

[2]Other external loans in FY2014/15 include program loans from the World Bank for the financing of agriculture and education SWAPs and the National AIDS Commission (NAC).

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

Table 2b. Malawi: Central Government Operations, 2012/13–2018/19

(Percent of GDP)

	2012/13	2013/14	2014/15	2015/16		2016/17	2017/18	2018/19
	Actual	Actual	Actual	Budget	Proj.	Proj.		
Revenue	27.5	22.8	21.4	21.6	22.4	22.2	22.5	22.6
Tax and nontax revenue	17.3	19.7	18.6	18.8	18.5	18.6	18.9	19.1
Tax Revenue	15.7	17.3	16.3	16.7	16.5	16.5	16.7	16.9
Taxes on income and profits	7.5	8.1	8.2	8.3	8.3	8.3	8.4	8.4
Taxes on goods and services	6.4	7.5	6.6	7.0	6.8	6.8	7.0	7.1
Taxes on international trade	1.9	1.8	1.6	1.7	1.6	1.7	1.7	1.7
Other taxes	-0.2	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4	-0.4
Nontax revenue [1]	1.6	2.4	2.4	2.1	2.1	2.1	2.2	2.2
Grants	10.2	3.1	2.8	2.7	3.9	3.5	3.6	3.6
Budget support grants	4.5	0.3	0.0	0.2	0.6	0.0	0.0	0.0
Project grants	2.0	1.8	1.7	1.5	1.9	1.5	1.3	1.3
Dedicated grants	3.7	1.0	1.1	1.1	1.4	2.0	2.2	2.3
Expenditure and net lending	28.5	28.9	27.1	26.3	26.2	24.7	25.3	25.2
Current expenditure	22.4	24.4	21.8	19.9	19.4	19.2	19.4	19.4
Wages and salaries	5.7	6.2	6.9	6.5	6.6	6.5	6.4	6.3
Interest payments	1.9	4.4	4.0	3.5	3.3	3.1	3.2	2.9
Domestic	1.7	4.2	3.8	2.9	3.0	2.8	2.9	2.6
Foreign	0.2	0.2	0.3	0.7	0.3	0.3	0.3	0.3
Goods and services	8.4	7.9	5.5	5.5	5.1	5.4	5.5	5.9
Generic goods and services	3.5	2.9	2.7	2.1	2.0	2.1	2.1	2.3
Road Maintenance	0.4	0.4	0.3	0.6	0.6	0.6	0.7	0.9
Agricultural swap	0.0	0.4	0.0	0.2	0.2	0.2	0.2	0.2
Health SWAp	1.8	0.9	0.8	0.9	0.9	1.0	1.0	1.0
Education SWAp	1.3	0.9	0.8	0.6	0.6	0.6	0.7	0.7
National / local elections	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
PFEM	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Statutory expenditures	0.3	0.3	0.3	0.2	0.1	0.1	0.1	0.1
National AIDS Commission	0.3	0.4	0.1	0.2	0.2	0.2	0.2	0.2
Maize purchases	0.2	0.6	0.2	0.4	0.2	0.2	0.2	0.2
Rural Electrification Program	0.5	0.5	0.2	0.2	0.2	0.2	0.2	0.2
Subsidies and other current transfers	5.7	5.6	4.9	4.4	4.4	4.2	4.3	4.3
Pension and gratuities	0.9	0.9	1.1	1.2	1.2	1.2	1.2	1.3
Transfers to road and revenue authorities	0.5	0.6	0.5	0.4	0.5	0.4	0.5	0.4
Transfers to public entities	1.3	1.4	1.4	1.6	1.5	1.4	1.4	1.4
Fertilizer and seed subsidy	3.0	2.7	1.9	1.2	1.2	1.2	1.2	1.2
Arrears payments	0.7	0.4	0.4	0.0	0.0	0.0	0.0	0.0
Development expenditure	6.1	4.5	5.3	6.3	6.8	5.5	5.9	5.8
Foreign financed	4.2	3.6	4.4	4.9	5.7	4.3	4.7	4.5
Domestically financed	1.8	0.9	1.0	1.4	1.1	1.2	1.2	1.3
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	-0.9	-6.1	-5.7	-4.7	-3.8	-2.5	-2.8	-2.6
Discrepancy	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-1.7	-6.1	-5.8	-4.7	-3.8	-2.5	-2.8	-2.6
Total financing (net)	1.8	6.1	5.8	3.9	3.8	2.5	2.8	2.6
Foreign financing (net)	1.9	2.0	2.5	3.2	3.1	2.2	2.8	2.6
Borrowing	2.2	2.4	2.9	3.7	3.7	2.8	3.4	3.2
Budget support loans	0.0	0.6	0.0	0.6	0.0	0.0	0.0	0.0
Project loans	2.2	1.8	2.2	2.8	3.4	2.8	3.4	3.2
Other external loans [2]	0.0	0.0	0.7	0.3	0.3	0.0	0.0	0.0
Amortization	-0.3	-0.4	-0.4	-0.5	-0.6	-0.6	-0.6	-0.6
Privatization proceeds	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0
Net domestic financing	-0.1	4.2	3.3	0.7	0.4	0.3	0.1	0.0
Financing gap	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0
Memorandum items:								
Domestic fiscal balance [3]	-7.0	-5.6	-4.1		-2.0	-1.8	-1.7	-1.6
New securitized arrears	---	1.7	0.6	1.4	---	---	---	---
Nominal GDP (fiscal year)	1,717	2,242	2,846	3,537	3,537	4,224	4,853	5,495

Sources: Malawi Ministry of Finance and IMF staff projections.

1. Non-tax revenues in 2013/14 and 2014/15 include the RBM profit transfer to government of MK19.2 billion and MK25.4, respectively.

2. Other external loans in FY2014/15 includes program loans from the World Bank for the financing of agriculture and education SWAPS and the national AIDS Commission (NAC).

3. Domestic fiscal balance is calculated by subtracting current and domestically-financed development expenditures from domestic revenues.

Table 3a. Malawi: Monetary Authorities' Survey, 2012–18

(Billions of Kwacha, unless otherwise indicated)

	2012	2013	2014	2015			2016	2017	2018
				Mar.	Jun.	Dec.		Proj.	
				Act.	Act.	Proj.			
Reserve money	113	157	212	197	213	275	334	383	446
Currency outside banks	55	76	98	81	112	...	...	...	...
Cash in vault	16	19	22	18	22	...	...	...	...
Commercial bank deposits with RBM	42	62	92	99	92	...	...	...	...
Net foreign assets (NFA)	-20	42	146	174	192	251	346	381	473
Foreign assets	80	174	277	293	311	396	490	551	673
Foreign liabilities	-100	-133	-131	-119	-119	-145	-144	-170	-200
Net domestic assets	133	115	66	23	21	24	-13	2	-26
Credit to government (net)	110	126	77	50	18	27	25	27	27
Credit to domestic banks	-14	0	0	0	6	0	0	0	0
Other items (net)	37	-11	-11	-28	-2	-3	-37	-25	-54
Open market operations	-14	-5	0	0	0	...	...	...	...
Others	51	-6	-11	-28	-2	...	...	...	...
Memorandum items:									
Money multiplier	3.4	3.3	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Annual growth of reserve money (percent)	54.6	38.6	35.3	16.5	10.2	29.6	21.3	14.8	16.4
91-day treasury bill rate	20.0	32.3	26.9	25.7	26.9	...	...	...	...
NFA (US$ millions)	-50	99	310	399	434	433	527	540	629
Foreign assets (US$ millions)	247	404	588	670	705	683	745	781	895
Foreign liabilities (US$ millions)	-297	-305	-278	-272	-271	-250	-219	-241	-267

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

Table 3b. Malawi: Monetary Survey, 2012–18

(Billions of Kwacha, unless otherwise indicated)

	2012	2013	2014	2015			2016	2017	2018
				Mar.	Jun.	Dec.		Proj.	
				Act.	Act.	Proj.			
Money and quasi-money	386	522	630	594	642	830	1,007	1,156	1,346
Money	222	201	275	247	289	...	...	...	...
Quasi-money	164	321	355	348	353	...	...	...	...
Of which: foreign currency deposits	72	139	143	120	130	...	...	...	...
Net foreign assets (NFA)	32	134	242	227	256	391	516	576	680
Monetary authorities	-20	42	146	174	192	251	346	381	473
Gross foreign assets	80	174	277	293	311	396	490	551	673
Foreign liabilities	-100	-133	-131	-119	-119	-145	-144	-170	-200
Commercial banks (net)	51	92	96	53	64	140	169	195	207
Net domestic assets	355	388	388	367	386	439	491	580	666
Credit to government (net)	141	184	153	174	149	168	163	167	168
Credit to statutory bodies (net)	19	18	4	5	6	6	7	10	12
Credit to private sector	219	250	301	298	312	346	403	478	571
Other items (net)	-24	-65	-70	-111	-80	-81	-81	-75	-84
Memorandum items:									
Velocity of money (annualized GDP divided by broad money)	3.9	3.9	4.1	...	...	3.9	3.9	3.9	3.9
Annual growth of broad money (percent)	22.9	35.1	20.7	11.9	13.8	31.8	21.3	14.8	16.4
Annual growth of credit to the private sector (percent)	25.4	14.4	20.0	11.0	13.6	15.1	16.5	18.6	19.5
NFA of the commercial banks (US$ millions)	153.3	212.3	203.2	262.6	145.8	242.6	257.6	275.6	275.6
Gross foreign assets (US$ millions)	199.5	242.1	239.9	270.0	168.2	250.0	265.0	283.0	283.0
Foreign liabilities (US$ millions)	-46.3	-29.8	-36.7	-7.4	-22.4	-7.4	-7.4	-7.4	-7.4
Foreign currency deposits(US$ millions)	218.2	325.5	304.0	274.9	293.9	...	...	...	...
Nominal GDP (billions of Kwacha)	1502	2011	2,570			3,198	3,933	4,564	5,190

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

Table 4a. Malawi: Balance of Payments, 2012–18

(US$ millions, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018
	Act.	Est.	Est.	Proj.		Proj.	
Current account balance (including grants)	-554.9	-471.2	-489.4	-510.9	-501.2	-525.5	-543.9
Merchandise trade balance	-659.1	-442.8	-444.1	-431.2	-327.5	-377.5	-382.4
Exports	1,272.2	1,500.0	1,575.6	1,417.8	1,566.8	1,696.7	1,805.4
Of which: Tobacco	481.0	432.9	480.8	474.3	492.7	502.2	527.3
Uranium	154.4	169.9	40.4	0.0	0.0	0.0	0.0
Imports	-1,931.3	-1,942.8	-2,019.7	-1,849.0	-1,894.4	-2,074.2	-2,187.8
Of which : Petroleum	-173.7	-176.6	-183.0	-112.8	-122.1	-150.5	-173.6
Services balance	-336.3	-375.0	-353.5	-410.2	-445.0	-438.8	-477.2
Interest public sector	-10.0	-9.1	-8.7	-57.1	-42.4	-43.2	-45.0
Other factor payments (net)	-124.8	-150.3	-151.9	-156.6	-163.9	-181.6	-201.8
Nonfactor (net)	-243.9	-215.6	-192.9	-196.4	-238.7	-214.1	-230.4
Receipts	148.8	156.5	175.4	140.6	130.9	164.0	137.8
Payments	-350.4	-372.1	-368.3	-337.0	-369.6	-378.1	-368.2
Unrequited transfers (net)	440.5	346.6	308.2	330.5	271.3	290.8	315.7
Private (net)	259.8	274.4	309.0	307.8	258.2	291.6	316.5
Official (net)	180.7	72.2	-0.8	22.7	13.2	-0.8	-0.8
Receipts	181.4	73.0	0.0	23.5	14.0	0.0	0.0
Budget support	181.4	73.0	0.0	23.5	14.0	0.0	0.0
Payments	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Capital account balance	409.8	433.6	261.1	308.0	333.4	353.6	362.3
Project and dedicated grants[1]	409.8	433.6	261.1	308.0	333.4	353.6	362.3
Financial account balance	243.3	238.7	452.6	245.7	172.5	207.6	296.2
Medium- and long-term flows (net)	76.0	86.0	135.5	92.3	18.5	44.1	148.2
Disbursements	93.4	96.7	200.6	183.8	169.6	194.5	220.8
Budget support and other program loans	0.0	22.4	40.0	0.0	0.0	0.0	0.0
Project support	76.0	63.3	145.6	183.8	169.6	194.5	220.8
Other medium-term loans	17.4	11.1	15.0	0.0	0.0	0.0	0.0
Amortization	-17.4	-10.7	-65.1	-91.4	-151.1	-150.4	-72.6
Foreign direct investment and other inflows	81.9	92.9	296.0	142.5	138.1	144.5	147.0
Short-term capital	0.7	0.8	0.8	0.9	0.9	0.9	1.0
Commercial banks net foreign assets	84.7	59.1	20.3	10.0	15.0	18.0	0.0
Errors and omissions	-5.0	-32.5	-84	0	0	0	0.0
Overall balance	93.3	168.6	163.7	67.7	30.9	58.0	140.3
Financing	-93.3	-168.6	-163.7	-67.7	-30.9	-58.0	-140.3
Gross reserves (- increase)	-45.6	-161.2	-190.6	-95.6	-62.1	-35.6	-114.6
Liabilities	-47.6	-7.4	26.9	27.9	31.2	-22.4	-25.7
Of which: IMF (net)	37.0	12.5	-5.8	-5.6	31.2	-22.4	-25.7
Purchases/drawings	40.2	20.1	17.6	19.3	57.4	0.0	0.0
Repurchases/repayments	3.2	7.6	23.5	24.8	26.2	22.4	25.7
Memorandum items:							
Gross official reserves	235.8	397.0	587.6	683.2	745.3	772.2	895.4
Months of imports[2]	1.2	2.0	3.2	3.6	3.6	3.7	3.7
Current account balance (percent of GDP)							
Excluding official transfers	-12.3	-10.0	-8.1	-8.3	-8.0	-7.8	-7.6
Including official transfers	-9.3	-8.7	-8.1	-7.9	-7.8	-7.8	-7.7
Import price index (2005 = 100)	129.3	127.9	125.6	112.9	113.6	115.9	117.2
Import volume (percent change)	-6.9	-0.2	5.1	-6.8	3.7	4.4	6.4
REER (percent change)	-17.9	-14.9	8.8	...	...	...	...
Overall balance (percent of GDP)	1.6	3.1	2.7	1.0	0.5	0.9	2.0
Terms of trade (percent change)	-2.6	1.1	1.5	11.1	-1.5	-3.0	-1.1
Nominal GDP (millions of U.S. dollars)	5,980.6	5,432.2	6,055.3	6,460.9	6,428.9	6,737.6	7,104.3

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

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

[2] In months of imports of goods and nonfactor services in the following year.

Table 4b. Malawi: Balance of Payments, 2012–18

(Percent of GDP)

	2012	2013	2014	2015	2016	2017	2018
	Act.	Est.	Est.	Proj.	Proj.		
Current account balance (including grants)	-9.3	-8.7	-8.1	-7.9	-7.8	-7.8	-7.7
Merchandise trade balance	-11.0	-8.2	-7.3	-6.7	-5.1	-5.6	-5.4
Exports	21.3	27.6	26.0	21.9	24.4	25.2	25.4
Of which: Tobacco	8.0	8.0	7.9	7.3	7.7	7.5	7.4
Uranium	2.6	3.1	0.7	0.0	0.0	0.0	0.0
Imports	-32.3	-35.8	-33.4	-28.6	-29.5	-30.8	-30.8
Of which : Petroleum	-2.9	-3.3	-3.0	-1.7	-1.9	-2.2	-2.4
Services balance	-5.6	-6.9	-5.8	-6.3	-6.9	-6.5	-6.7
Interest public sector (net)	-0.2	-0.2	-0.1	-0.9	-0.7	-0.6	-0.6
Other factor payments (net)	-2.1	-2.8	-2.5	-2.4	-2.5	-2.7	-2.8
Nonfactor (net)	-4.1	-4.0	-3.2	-3.0	-3.7	-3.2	-3.2
Transfers (net)	7.4	6.4	5.1	5.1	4.2	4.3	4.4
Private (net)	4.3	5.1	5.1	4.8	4.0	4.3	4.5
Official (net)	3.0	1.3	0.0	0.4	0.2	0.0	0.0
Receipts	3.0	1.3	0.0	0.4	0.2	0.0	0.0
Budget support	3.0	1.3	0.0	0.4	0.2	0.0	0.0
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account balance	6.9	8.0	4.3	4.8	5.2	5.2	5.1
Project and dedicated grants	6.9	8.0	4.3	4.8	5.2	5.2	5.1
Financial account balance	4.1	4.4	7.5	3.8	2.7	3.1	4.2
Medium- and long-term flows (net)	1.3	1.6	2.2	1.4	0.3	0.7	2.1
Loan disbursements	1.6	1.8	3.3	2.8	2.6	2.9	3.1
Budget support and other program loans	0.0	0.4	0.7	0.0	0.0	0.0	0.0
Project support loans	1.3	1.2	2.4	2.8	2.6	2.9	3.1
Other medium-term loans	0.3	0.2	0.2	0.0	0.0	0.0	0.0
Amortization	-0.3	-0.2	-1.1	-1.4	-2.4	-2.2	-1.0
Foreign direct investment and other inflows	1.4	1.7	4.9	2.2	2.1	2.1	2.1
Commercial banks net foreign assets	1.4	1.1	0.3	0.2	0.2	0.3	0.0
Errors and omissions	-0.1	-0.6	-1.4	0.0	0.0	0.0	0.0
Overall balance	1.6	3.1	2.7	1.0	0.5	0.9	2.0
Financing	-1.6	-3.1	-2.7	-1.0	-0.5	-0.9	-2.0
Gross reserves (- increase)	-0.8	-3.0	-3.1	-1.5	-1.0	-0.5	-1.6
Liabilities	-0.8	-0.1	0.4	0.4	0.5	-0.3	-0.4
Of which: IMF (net)	0.6	0.2	-0.1	-0.1	0.5	-0.3	-0.4
Purchases/drawings	0.7	0.4	0.3	0.3	0.9	0.0	0.0
Repurchases/repayments	0.1	0.1	0.4	0.4	0.4	0.3	0.4
Memorandum items:							
Gross official reserves	3.9	7.3	9.7	10.6	11.6	11.5	12.6
Current account balance (percent of GDP)							
Excluding official transfers	-12.3	-10.0	-8.1	-8.3	-8.0	-7.8	-7.6
Including official transfers	-9.3	-8.7	-8.1	-7.9	-7.8	-7.8	-7.7
Value of exports of GNFs (percent change)	0.9	16.6	5.7	-11.0	8.9	9.6	4.4
Value of imports of GNFs (percent change)	2.0	1.5	3.2	-8.5	3.6	8.3	4.2

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

Table 5. Malawi: Selected Banking Soundness Indicators, December 2011–June 2015

Key ratios	Dec-11	Jun-12	Dec-12	Jun-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec. 14	March 15	June 15
Capital Adequacy											
1. Regulatory Tier 1 capital to risk weighted assets	16.5	16.2	16.4	16.1	16.2	14.8	14.9	14.2	13.5	16.1	15.0
2. Regulatory total capital to risk weighted assets	20.1	19.2	20.2	19.4	19.1	18.3	18.3	17.4	17.1	20.2	19.4
3. Total capital to total assets	14.6	13.9	14.3	15.1	15.4	17.1	17.9	18.4	17.6	20.3	16.6
Asset composition and quality											
1. Non-performing loans to gross loans and advances	4.1	5.5	9.4	12.6	15.4	15.9	16.1	15.6	14.9	14.8	13.8
2. Provisions to non-performing loans	36.9	30.5	26.8	30.5	29.1	30.3	28.3	30.7	31.8	33.4	34.7
3. Total loans and advances to total assets	52.7	53.3	50.8	45.4	40.5	41.7	42.1	41.3	40.3	43.3	41.0
4. Foreign currency loans to total loans and advances	6.1	9.4	7.9	10.5	13.5	15.2	18.1	17.1	19.1	21.4	16.1
Earnings and profitability											
1. Return on assets (ROA)	3.5	5.1	5.0	4.7	4.8	4.5	4.9	4.6	4.0	4.2	4.2
2. Return on equity (ROE)	24.7	36.7	36.9	36.2	37.5	31.9	33.5	30.9	26.8	25.0	24.9
3. Non-interest expenses to gross income	46.0	44.3	36.8	37.8	39.7	43.9	43.2	42.9	45.4	47.3	48.0
4. Interest margin to gross income	46.0	37.9	36.8	38.9	39.7	46.4	43.1	44.0	---	---	48.9
5. Non-Interest Income to Revenue			-	-	31.8	33.0	36	37.2	37.8	32.5	32.0
6. Net Interest Income to Assets			-	-	9.1	2.4	4.7	6.9	8.4	2.7	5.9
7. Personnel expenses to non-interest expenses	39.70	46.51	46.00	46.79	45.40	46.9	45.7	47.4	45.1	49.8	49.1
Liquidity											
1. Liquid assets to deposits and short-term liabilities	43.0	42.5	45.4	48.6	59.1	57.1	57.6	58.4	62.4	64.5	62.5
2. Total loans to total deposits	70.9	75.9	72.4	64.8	56.6	60.1	62.0	61.7	58.3	60.6	61.4
3. Liquid Assets to total assets	33.4	32.6	34.5	35.6	43.7	41.2	41.4	41.5	48.8	40.5	43.5
4. Foreign exchange liabilities to total liabilities	7.8	n.a.	17.9	n.a.	26.3	n.a.	n.a.	n.a.	---	---	16.1

Source: Reserve Bank of Malawi.

Annex I. Responses to 2012 Article IV Consultation's Key Recommendations

Achieve macroeconomic stability and contain inflation. The floating exchange regime and automatic oil pricing mechanism have helped in the adjustment to external shocks but large shocks and uneven policies prevented the attainment of low inflation.

Increase international reserves. Foreign reserves cover has gradually risen, reaching three months of imports towards end-2014.

Improving social indicators. Malawi had made good progress in (i) reducing child mortality; (ii) gender parity in primary school enrollment; and (iii) access to water and electricity.

Strengthen public financial management. The "cash-gate" scandal exposed weakness in PFM systems and highlighted the urgency of reforms. Implementation of reforms has been slow.

Ensure fiscal sustainability. Malawi's risk of debt distress is moderate but ongoing external financing shortfalls have led to increased recourse to domestic financing.

Strengthen the operational independence of the RBM. The RBM Act which limits credit to government to a 10 percent of the previous year's revenue has been approved by parliament and enacted into law.

Safeguard financial stability. Good progress has been made in implementing monetary and financial benchmarks, including the submission of amendments to the Banking Act and Financial Services Act to parliament. Two weak banks were sold and are being recapitalized.

Enhance growth sustainability and inclusiveness. Progress has been made on access to finance and health although the business climate has deteriorated and key supply-side bottlenecks still constrain economic development.

Scale up social protection programs. Progress was made in: (i) increasing primary school enrollment including gender parity; (ii) improving access to potable water; and (iii) declining infant mortality rates.

Annex II. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood in next 1–3 years	Impact if Realized	Policy advice[2]
		Global Risks	
A surge in global financial volatility and decompression of credit spreads following slow growth as well as protracted policy uncertainty in Euro area.	**High**	**Low** Increased financial volatility could cause foreign investors to become more risk averse and reduce financial flows, which could contribute to the depreciation of the currency, elevate inflationary pressures and undermine growth prospects.	Keep fiscal discipline and make monetary policy consistent with growth and inflation objectives, maintain adequate foreign reserves and smooth short term exchange rate volatility.
Weak demand in key advanced economies.	**High**	**Medium** Weakness in external demand could dampen Malawi's exports and contribute to lower real GDP growth.	Adopt policies to increase fiscal space to respond to contingences.
Increased volatility of energy price due to uncertainty about the oil supply shock.	**Medium**	**Medium** The associated price fluctuation could add to existing macroeconomic uncertainties.	Tighten monetary policy to send a clear signal to market participants, and use the automatic price adjustment mechanism to smooth excessive price movement and ensure adequate fuel supplies.
		Regional and Domestic Risks	
Expansionary fiscal policy.	**High**	**High** An unduly high fiscal deficit increase domestic borrowing crowd out the private sector and likely lead to the reemergence of payment arrears.	Adopt corrective measures to contain spending, exert better commitment control and increase revenue mobilization.
Delay in PFM reform.	**Medium**	**High** Progress of PFM reform has been uneven, which undermines donor's confidence in budgetary processes.	Accelerate the implementation of PFM reforms and regularly communicate progress to donors.
Deficiencies in the conduct of monetary policy.	**Medium**	**High** Conflicting signals by the RBM could cause market participants lose confidence in the RBM's commitment to fight inflation.	Improve the communication of monetary policy and adopt a clear and effective monetary operational framework.
Financial Stability.	**Medium**	**Medium** The high level of non-performing loans and high concentration risk could ultimately undermine financial sector stability.	Strengthen banking supervision and inspection to contain emerging risks by developing early warning systems.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline scenario path, which is most likely to materialize in the view of IMF staff. The Relative Likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline scenario.

[2] The policy response suggested by IMF staff assumes all other things unchanged. For a combination of shocks, policy responses would need to be modified to avoid conflicts.

Annex III. External Stability Assessment

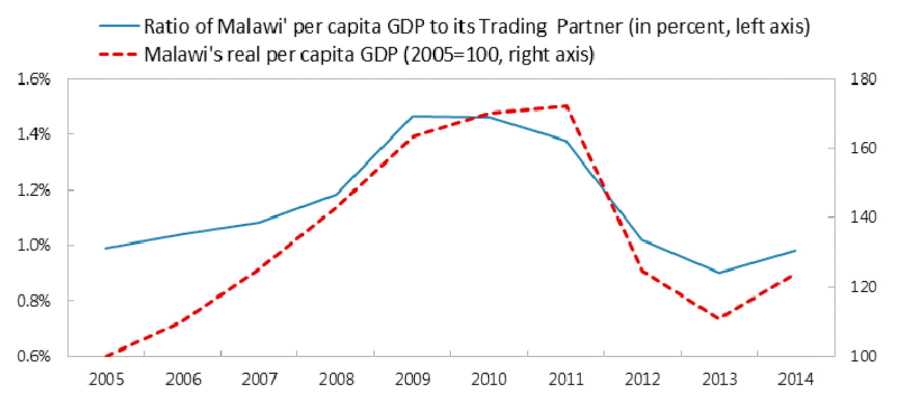
This annex evaluates the external competitiveness, possible misalignments of the exchange rate, and the adequacy of external reserves. Standard exchange rate assessment methods point to the kwacha being roughly in line with fundamentals in 2014. However non-price indicators suggest there is scope to improve Malawi's external sector competitiveness. An assessment of reserve adequacy suggests a range of 3–6 months of import cover for precautionary motives, given high volatility of external aid flows and the terms of trade.

A. External Competitiveness and Exchange Rate Assessment

Malawi's high external current account deficit reflects structural factors. Ongoing economic development requires large investment-related imports, which alongside a narrow export base lead to a structurally high deficit. The deficit also reflects the high growth rate of the population. The deficit is mostly financed by foreign direct investment, public sector loans and aid flows (although direct budget support has been volatile and has declined substantially in recent years).

Malawi lags behind its trading partners in productivity growth (Annex Figure 1). Despite strong productivity during 2005–11, adverse external and internal economic shocks in 2012 and 2013 jointly dragged Malawi's productivity back to its 2006 level. Relative productivity, measured by the ratio of per-capita GDP of Malawi to the average of its trading partners, has worsened in recent years.

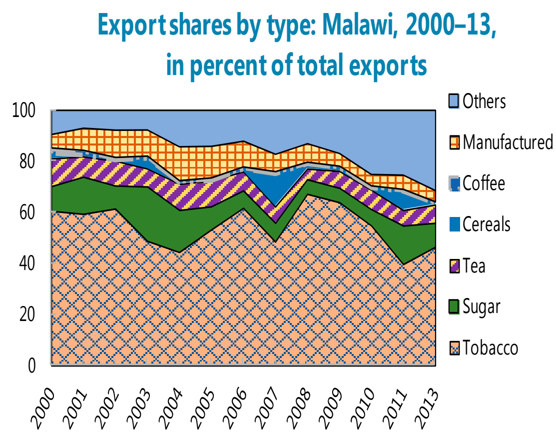
Annex Figure 1. Real Per Capita GDP, ratio to trading Partner, 2005–14

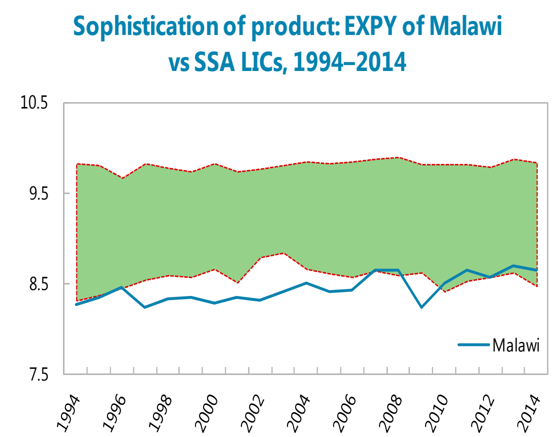


Source: WEO

Malawi's exports are highly concentrated in agricultural commodities (Annex Figure 2). The top three products account for about two-thirds of total exports. In 2013, exports of tobacco, sugar, and tea yielded US$ 763 million (18 percent of GDP) while exports of manufactured goods were only US$ 55 million (1.3 percent of GDP).

Annex Figure 2. Exports





Source: UN Comtrade.

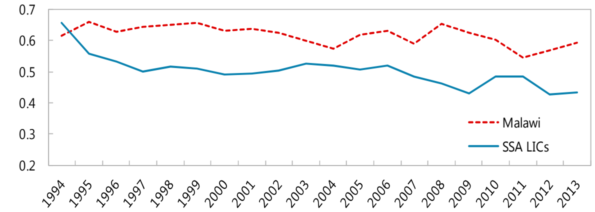
Notes: 1, The index of Sophistication of Exports, EXPY, is a measure for the level of technological sophistication embodied in a country's export portfolio. The larger the value is, the more sophisticated the export goods are.

Malawi has lagged behind SSA LICs in terms of export diversification and quality in recent years (Annex Figure 3). Regarding product diversification, the normalized Theil index illustrates that Malawi' export goods are persistently less diversified than those of SSA LICs and have not demonstrated a sustained improvement. For country diversification, Malawi appears to show similar trends. Little progress has been made on trade diversification based on the extensive margin.[1] This is confirmed by the Hummels-Klenow index, although the number of trading partners of Malawi has increased. Similar results were found for export quality (EXPY), which suggests that Malawi is at the low end of the distribution of export sophistication of SSA LICs (highlighted by the green area).

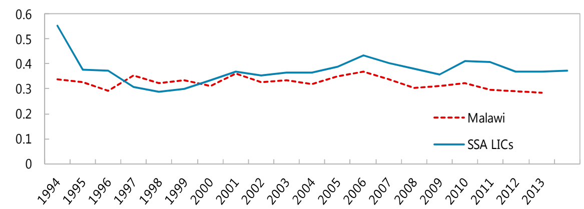
[1] The extensive margin refers to the degree of product diversification and trading partner diversification.

Annex Figure 3. Export Margins

Theil Index (Normalized) on the product margin: Malawi vs SSA LICs, 1994–2013



Theil Index (Normalized) on the country margin: Malawi vs SSA LICs, 1994–2013

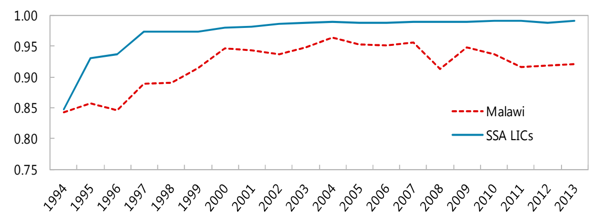


Source: UN Comtrade.

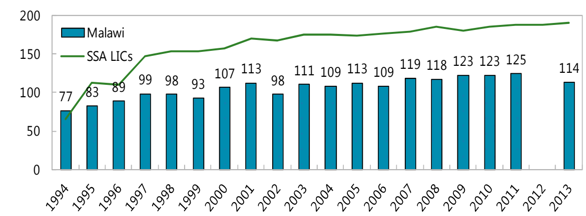
Notes: 1, The export data in 2012 is missing.

2, The Theil Index is a statistic to measure economic diversification. The smaller the value is, the more diversified the exports are. The Theil Index can be computed on two dimensions: product and country.

Hummels-Klenow index of (country) extensive margin: Malawi vs SSA LICs, 1994–2013



Number of trading partners: Malawi vs SSA LICs, 1994–2013



Source: UN COMTRADE.

Notes: 1, The export data in 2012 is missing.

2, The exports of WTO member countries are used for the total exports of the world.

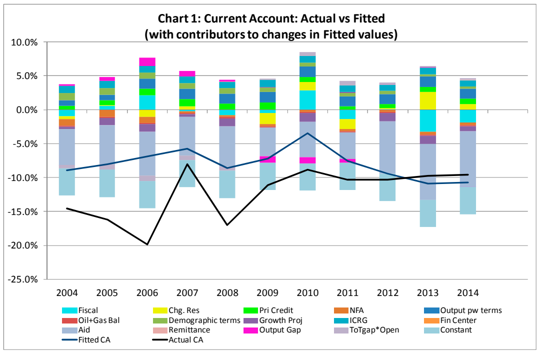
3, The Hummels-Klenow index of (country) extensive margin is defined as the share of world export to only those countries that a country of interest exports to in total world exports of all goods. The larger the value is, the more diversified the exports are.

Estimates indicate the real exchange rate was roughly in line with fundamentals by the end of 2014 (Annex Figures 4 and 5).[2] Malawi's current account norm is estimated at a deficit of -10.7 percent of GDP for 2014. The actual current account was slightly below 10 percent of GDP and the gap implies a very slight undervaluation of about 2 percent. Although controls for low income countries have been applied, Malawi's relatively low position within SSA means predictions from such regression may have to be nuanced by Malawi's particular conditions. Indeed, an approach based on direct estimation of the equilibrium exchange rate (based on a commodity price movement regression, "the commodity currency approach") suggests the Kwacha was roughly in equilibrium by 2014.[3]

[2] Current account balance calculations are based on the External Balance Assessment (EBA-lite) methodology (IMF Working Paper, WP/13/272), and employ elasticities for the current account in the range of -0.47,-0.20 of the current account balance to the exchange rate (IMF Working Paper, WP/10/180). Similar results are obtained through alternative standard methods for exchange rate assessment.

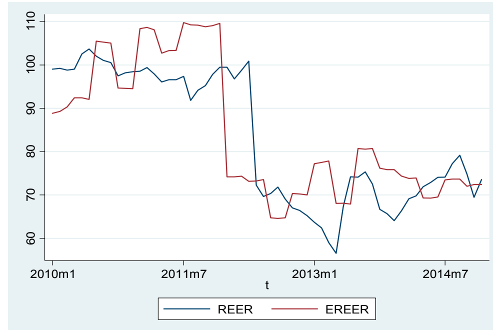
[3] Cashin et. al. (2002) "Keynes, Cocoa, and Copper: In Search of Commodity Currencies" IMF WP/02/223.

Annex Figure 4. Current Account Balance Estimates



Source: IMF Staff calculations

Annex Figure 5. Commodity Currency Approach

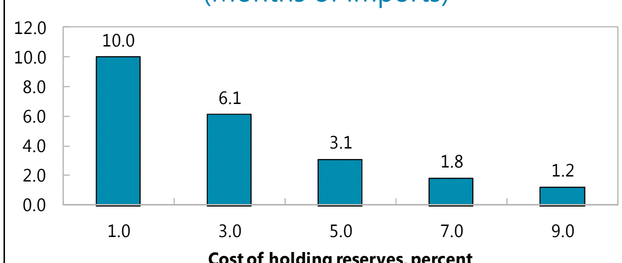


Source: IMF Staff calculations

Nonetheless, the high current account deficit warrants adjustment over the medium to long term. The weak performance of exports is a matter of concern that needs to be addressed over the medium term through structural transformation to increase economic productivity and competitiveness, and improve the quality of domestic production to partly substitute imports. Volatile capital account flows are also a concern that needs to be addressed as the country develops and becomes less dependent on external aid flows, which have proven to be highly volatile.

B. Adequacy of International Reserves

Annex Figure 6. Optimal Level of Reserves
(Months of imports)



Sources: Malawian authorities; and IMF staff estimates.

International reserves are within the range of desirable levels for precautionary purposes, but higher cover could be justified (Annex Figure 6).[4] Reserve coverage at end 2015 is expected to continue to improve and exceed 3 months of the next year's imports. Reserve coverage was at a low one month of imports prior to the current ECF program. Given Malawi's characteristics and external flow source volatility, the optimal level of reserves for precautionary motives is estimated at 3.1–6.1 months of the next year's imports, assuming a cost of holding reserves in the range of 3–5 percent. Additional motives that justify further reserve accumulation include the need to

[4] These calculations are based on the methodology discussed in the IMF policy paper "Assessing Reserve Adequacy-Specific Proposals," April 2015.

address volatile external flows, terms of trade shocks, and weather shocks impacting agricultural exports.

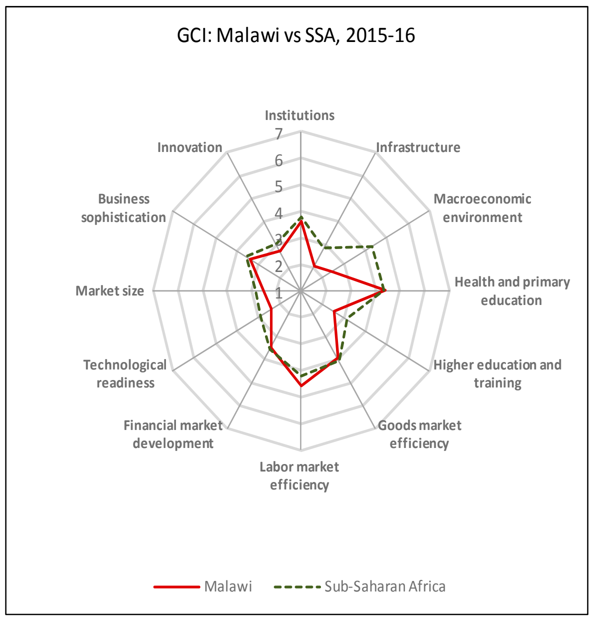
C. Non-Price Indicators

Malawi's business environment has been deteriorating in recent years (Annex Figure 7) In the 2015–16 Global Competitive Index (GCI) report, Malawi ranks 135th of 140 surveyed countries in 2015, a slight fall, and still behind the average level of sub-Saharan Africa (SSA). The World Bank's doing business indicators suggest a similar trend. The five major competitive constraints[5] are access to financing, corruption, crime and theft, tax rates, and inflation.

Annex Figure 7. Global Competitive Index

Global Competitiveness Index: Malawi vs SSA, 2015-16

	Malawi		Sub-Saharan Africa
	Rank (Out of 140)	Score (1-7)	Score (1-7)
GCI 2015–2016	135	3.2	3.6
GCI 2014–2015 (out of 144)	132	3.2	3.4
GCI 2013–2014 (out of 148)	136	3.3	3.6
GCI 2012–2013 (out of 144)	129	3.4	3.5
GCI 2011–2012 (out of 142)	117	3.6	3.1
Basic requirements (60%)	138	3.1	3.8
Institutions	92	3.6	3.8
Infrastructure	135	2.0	2.8
Macroeconomic environment	140	2.4	4.3
Health and primary education	121	4.4	4.3
Efficiency enhancers (35%)	127	3.2	3.5
Higher education and training	133	2.5	3.1
Goods market efficiency	117	3.9	4.1
Labor market efficiency	29	4.6	4.2
Financial market development	100	3.5	3.5
Technological readiness	133	2.4	2.9
Market size	127	2.5	2.9
Innovation and sophistication factors (5%)	119	3.1	3.3
Business sophistication	121	3.4	3.6
Innovation	121	2.7	3.1



Source: Global Competitive Index report from the World Economic Forum.

[5] These factors are based on the Global Competitiveness Report 2015–16.

INTERNATIONAL MONETARY FUND

MALAWI

November 30, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The African Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of September 30, 2015)

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	2.64	3.98

Outstanding Purchases and Loans:

	SDR Million	%Quota
ESF Arrangements	24.29	35.00
ECF Arrangements	96.58	139.17

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	07/23/2012	05/22/2016	104.10	52.06
ECF[1/]	02/19/2010	07/22/2012	52.05	13.88
ESF	12/03/2008	12/02/2009	52.05	34.70

[1]Formerly PRGF.

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

	Forthcoming				
	2015	**2016**	**2017**	**2018**	**2019**
Principal	3.47	17.86	15.71	20.41	11.89
Charges/Interest	0.01	0.03	0.06	0.05	0.18
Total	3.48	17.89	15.77	20.45	12.06

[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]	1,057.00
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 (RBM) with respect to the 2012 ECF arrangement was completed on December 27, 2012. The assessment reiterated the key safeguards concern – the lack of operational autonomy - and recommended that already envisaged amendments to the RBM Act to limit lending to government be expanded to strengthen RBM autonomy more broadly. The assessment also reiterated the need to enhance oversight of foreign reserves management along with measures to strengthen transparency of financial reporting.

Exchange Arrangements:

In May 2012, the government liberalized the foreign exchange regime, devalued the kwacha by about 33 percent, and adopted a floating exchange rate regime. Since May 2012, the RBM has not set a target rate and allowed substantial volatility in the exchange rate, including recent depreciation to around MK 555 per U.S. dollar at end-September 2015. Official actions continue to play a role in influencing the exchange rate, but the exchange rate movements are largely market determined and staff found that the authorities' practice of determining the exchange rate of commercial banks through moral suasion has ceased, thereby removing the official action that gave rise to the multiple currency practice identified in August 2006 and manifested by the significant spread between the commercial bank and foreign exchange bureau rates. Malawi maintains a system free from restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation:

Malawi is on a 24-month Article IV consultation cycle. The Executive Board concluded the last Article IV consultation with Malawi on July 23, 2012. The Article IV was delayed due to the program going off track in the wake of the "cashgate" scandal involving the large scale theft of public funds that came to light in October 2013.

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
10/15	STA	NSO	National accounts statistics	Mission
09/15	FAD	MOF	Pension reform proposals	Mission
09/15	FAD	MOF	Expenditure control, bank reconciliation, and fiscal reporting	Mission
07/15	FAD	MOF	Improving cash planning and management	Mission
06/15	STA	NSO	Price Statistics	Mission
05/15	FAD	RBM	TADAT Pilot Assessment	Mission
04/15	FAD	MOF	Implementing priority PFM reforms II	Mission
04/15	STA	NSO	National Accounts Statistics	Mission
03/15	LEG	RBM	Helping draft Banking law amendments	Mission
03/15	STA	MOF	Government Finance Statistics	Mission
02/15	STA	NSO	Balance of Payments Statistics	Mission
02/15	STA	NSO	National Accounts Statistics Harmonization	Workshop
02/15	MCM	RBM	Advice on the Implementation of ICAAP/SREP supervisory framework.	Mission
01/15	FAD	MOF	Action plan for implementing priority PFM reforms	Mission
11/14	STA	NSO	Assistance with redeveloping data	Mission
11/14	FAD	Ministry of Finance	PFM Action Plan follow-up	Mission
09/14	STA	NSO	Development of direct prices survey for MPIs	Mission
03/14	STA	NSO	Further Assistance on Data Improvement	Mission
03/14	FAD	Ministry of Finance	PFM Reform Program	Mission
11/13	STA	NSO	Balance of Payments Statistics	Mission
09/13	STA	NSO	Price Statistics	Mission
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

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
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 Cycle	Mission
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

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
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, Performance Measurement, and Budget Documentation	Report
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

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
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

JOINT MANAGERIAL ACTION PLAN

(October 27, 2015)

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. Country Economic Memorandum	On-going	August, 2016
	2. Disaster Risk Management technical assistance (including a Floods Poverty Impact Survey and Assessment)	On-going	October, 2016
	3. Programmatic Poverty Assessment		May, 2016
	4. Urbanization Review	December, 2015	December, 2015
	5. Growth and Competitiveness		June, 2016
	6. Malawi Economic Monitor (two editions)	February, 2016	October 2015 and April 2016
	Lending:		
	1. Lilongwe Water Project	December, 2016	May, 2016
	2. Fiscal Resilience Development Policy Operation	February, 2016	June, 2016
	3. Additional Financing to the Nutrition, HIV and AIDS Project	February, 2016	August, 2016
	3. Education Sector Improvement Project	October, 2015	July, 2016
	4. Public Service Reform Project	November, 2015	September, 2016
	5. Shire Valley Irrigation Project	October, 2015	April, 2017
	6. Agricultural Commercialization and Rural Growth Project	March, 2016	July, 2017
IMF work program in next 12 months	1. Eighth review of ECF-supported program	March 2016	May 2016
B. Requests for work program inputs			
Fund request to Bank	1. Updates on WB support to Malawi		Continuous
Bank request to IMF	1. Regular updates and exchange of views on medium-term macroeconomic and fiscal projections including sharing detailed excel tables on Real, Monetary, Fiscal and External Sectors		Continuous
C. Agreement on joint products and missions			
Joint products in next 12 months	1. Debt Sustainability Analysis (update)	January, 2016	Feb/March, 2016

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of September, 2015)

AfDB operations in Malawi date back to 1969. The Malawi Field Office was opened in 2007. As at 30th September, 2015, the Bank had provided significant and diversified support to Malawi, with cumulative commitments worth UA 873.7 million (about US$ 1.2 billion) to finance 102 operations including 12 studies and 2 lines of credit.

The AfDB Board of Directors on 30th January 2013 approved a new Country Strategy Paper (CSP) for Malawi covering 2013–17. The Bank's current 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 CSP, currently under implementation, focuses 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 and enhance competitiveness, the Bank has scaled-up support to regional infrastructure to deepen the country's integration with its neighbors. In 2014, the Bank approved the Nacala Road Corridor Phase IV Project while other regional infrastructure projects are in the pipeline, including the Malawi-Mozambique Power Inter-connector Project. The Bank will also support Public Private Partnerships (PPPs) in infrastructure development. The CSP mid- term review was undertaken in 2015 and the strategic priorities have been maintained.

The Bank has deepened its support for PFM Reforms and capacity building in coordination with other Development Partners. In September, 2015, the Bank approved a grant of US $ 2.61 million for Phase II of the on-going PFM Institutional Support (ISP). ISP II is providing support for two components: (i) enhancing transparency, control and compliance in the area of procurement and; (ii) strengthening capacity in revenue administration. This was in addition to the US$ 4.2 million approved in 2013 for the PFMISP I.

The Bank has also provided Malawi with quick disbursing budget support. 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 UA 26 million (US$ 36 million). The Bank designed the Restoration of Fiscal Stability and Social Protection (RFSSP) program whose objective was 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 had two components: (i) strengthened PFM transparency and accountability, and (ii) strengthened social protection system. The Bank disbursed UA 4 million (US$ 5.6 million) as additional budgetary support in June 2013. In April, 2015, the Bank approved a grant of US $ 30 million for the Protection of Basic Services Programme. This is a ring fenced Sector Budget

Support programme, which is designed to protect critical expenditures in health, education and social protection and improve accountability following suspension of general budget support. The grant was disbursed in one tranche in July, 2015.

Box. AfDB Ongoing Operations

The Bank's ongoing operations comprise the following: two projects in the agriculture sector: (i) Agriculture Infrastructure Support Project (AISP); and (ii) Climate Adaptation for Rural Livelihoods and Agriculture Project (grant from Global Environment Facility). There are currently three projects providing support to the social sector and for economic empowerment: (i) the Local Economic Development project is developing infrastructure in four rural growth centers of Jenda, Malomo, Monkey Bay and Chitekesa; (ii) 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 (iii) 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 on Information and Communication Technology (ICT). In the transport sector the Bank is providing support for the Mzuzu-Nkhata Bay Road Rehabilitation Project and the Multinational Nacala Road Corridor Phase IV. As at 30th September 2015, the overall Bank portfolio was rated satisfactory with an average disbursement rate of 30%. In the water sector, the Bank is providing support for the Sustainable Rural Water and Sanitation for Improved Health and Livelihood Project to improve access to water. In line with the CSP program, the Bank approved three new operations in 2015; the Protection of Basic Services Programme (US $ 30 million), the Public Financial Management Institutional Support II (US $ 2.61 million) and the Mzimba Urban Water Integrated Project (US$ 5.0 million). The latter project is co-financed with OPEC Fund for International Development.

The Bank has also provided support for non-lending activities, including feasibility studies and analytic work to inform the design of new operations and policy dialogue. In 2013, the Bank collaborated with the World Bank and other partners on the Public Expenditure Review. The Bank has in addition provided support for the Public Expenditure Tracking Study in collaboration with other DPs. In addition, the Bank is supporting the Private Public Partnership Commission (PPPC) with a grant to implement the Capacity Building and Assessment of the Legislative and Institutional Framework for PPPs in Malawi. The Bank also undertook the Domestic Resource Mobilization Study for Malawi in 2013/2014 and provided TA to the Reserve Bank of Malawi to strengthen capacity in macro-economic forecasting.

STATISTICAL ISSUES

MALAWI—STATISTICAL ISSUES APPENDIX

As of November 2, 2015

I. Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but it is broadly adequate for surveillance.

National Accounts: STA is providing technical assistance (TA) to the National Statistics Office (NSO) on strengthening the quality of national accounts statistics. The NSO has revised the national accounts methodology to improve the consistency with the 2008 SNA and develop preliminary quarterly estimates of GDP by economic activity. Further TA is being provided to develop quarterly GDP estimates by expenditure components. Main operational challenges are the NSO's continuing budget constraints, the lack of funds to implement the requisite data collections, and low staffing levels in the national accounts unit.

Price Statistics: An updated and revised consumer price index (CPI) was introduced in January 2013. The weight reference period is 2010–11 (based on expenditure data collected from the 2010–11 integrated household survey), and an index reference period of 2012 (2012=100). In addition to new weights and items, the updated CPI reflects improved index calculation methods, the implementation of the internationally recommended Classification of Individual Consumption by Purpose (COICOP), and improved compilation methods. In April 2013, an updated PPI for manufacturing was released. The new PPI reflects updated weights. There remains a need to expand the coverage of the PPI to include additional economic activities. The NSO is in process of developing export-import price indexes.

Government Finance Statistics: The accuracy and reliability of the data are affected by source data weaknesses. A key shortcoming in this area is the inadequate system of recording source data. In addition, there are serious quality problems, including data inconsistencies, that complicate program monitoring:

- Due primarily to differences in coverage, published data for the budgetary central government include a sizeable statistical discrepancy between above and below the line data. The coverage of government for above the line data is considerably narrower than the information on financing reported by RBM.
- 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. This is a result of the way taxes are reported, and timing differences between receipt of taxes and cleared funds being available for the government. The finances and operations of the Malawi Revenue Authority are also unusually opaque.
- Nontax revenue, including capital revenues collected by line ministries, is not properly accounted for in the fiscal reports prepared by the Ministry of Finance.

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 the chart of accounts and output-based structures so that they could more easily be realigned to the national strategy and be more readily understood. Government finance data for the Budgetary Central Government in a GFSM 2001 presentation are reported for publication in the Government Finance Statistics Yearbook (GFSY) and International Financial Statistics (IFS). However these data are not disseminated domestically. 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 last mission proposed, and discussed with the authorities, a migration plan and timetable to adopt the GFSM 2001 methodology.
Monetary and Financial Statistics: 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[1]; 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 STA missions 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). The Reserve Bank of Malawi (RBM) reports monetary data on a regular basis, with monthly data disseminated through the IFS. The RBM recently revamped ODCs' call report templates to ensure their consistency with the methodology outlined in the MFS Manual. Despite these improvements, progress toward full adoption of the SRF-based monetary statistics is hindered by the quality of the underlying source data for ODCs, where ODCs' balance sheets and their supporting data schedules do not always match.
Financial Sector Surveillance: Malawi does not report FSIs to STA.
External sector statistics: The external sector statistics in Malawi exhibit some deficiencies. Concepts and definitions used to compile the balance of payments statistics are in broad conformity with the guidelines presented in the fifth edition of the Balance of Payments Manual (BPM5). The National Statistical Office of Malawi (NSO) should now adopt the BPM6 methodology, on the basis of which the

[1] Some legislation that is designed to address this issue has recently been approved.

Malawi balance of payments metadata should also be updated. The NSO balance of payments section remains critically 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.

The NSO compiles balance of payments based on BOP survey, ITRS, and exchange control record as primary sources of data. The NSO also compiles information from other important sources as well, namely: a) the Foreign Private Capital and Investor Perception Survey, b) monetary statistics from the Reserve Bank of Malawi (RBM), c) other financial data provided by the Ministry of Finance (MoF), and d) data from international organizations However, much remains to be done to improve the quality, coverage, and timelines of the balance of payments statistics. Data on foreign direct investment and portfolio flows remains 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. To this end, the NSO is a recipient of substantial amounts of technical assistance from the Fund and other organization. External support should be underpinned by providing adequate staffing and budget resources to the NSO.

Due to capacity constraints and weak source data, the International Investment Position (IIP) is not being compiled. Capacity building programs, including Fund-provided training and technical assistance, seek to overcome these constraints to allow the compilation of the IIP in future. The RBM and Ministry of Finance's Debt and Aid Department need to improve reporting of monetary and external debt data respectively.

II. Data Standards and Quality

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.	Data ROSC was published on February 17, 2005.

III. Reporting to STA

The authorities report the following datasets to STA for publication in the International Financial Statistics (IFS): Monetary and financial statistics, balance of payments and international investment position statistics, and government finance statistics; however timeliness is irregular.

Malawi: Tables of Common Indicators Required for Surveillance

(As of November 2, 2015)

	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]	Memo Items:[8] Data Quality — Accuracy and reliability[10]
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	8/2015	10/2015	M	M	M		
Reserve/Base Money	8/2015	10/2015	M	M	M	LO, LO, LNO, O	LO, O, O, O, O
Broad Money	8/2015	10/2015	M	M	M		
Central Bank Balance Sheet	8/2015	10/2015	M	M	M		
Consolidated Balance Sheet of the Banking System	8/2015	10/2015	M	M	M		
Interest Rates[2]	8/2015	10/2015	M	M	M		
Consumer Price Index	9/2015	10/2015	M	M	M	O, LNO, O, O	LNO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA.	NA				O, LO, O, O	O, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	6/2015	09/2015	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Domestic Debt[5]	6/2015	9/2015	M	M	M		
External Current Account Balance	12/2014	09/2015	A	A	A	O, O, O, O	LO, O, LO, O, O
Exports and Imports of Goods and Services	12/2014	09/2015	A	A	A		
GDP/GNP	12/2014	09/2015	A	A	A	LO, LNO, LNO, LO	LNO, LNO, LO, LO, LNO
Gross External Debt	12/2014	09/2015	A	I	I		
International Investment Position[6]	2013	2014	I	I	I		

[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 discounts 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.

Statement by Mr. Mkwezalamba, Alternate Executive Director for Malawi, and Mr. Sitima-wina, Senior Advisor to the Executive Director for Malawi, December 11, 2015

1. We thank staff for the constructive engagement with the Malawian authorities during the recent Article IV consultations. My authorities find the report to be a fair representation of what was discussed and therefore broadly concur with the staff assessment and conclusions.

2. My authorities appreciate the fact that the staff report takes into account a series of adverse shocks that hit the Malawi economy, heavily impacting on policy implementation, and rendering the attainment of its national development objectives, articulated in the second Malawi Growth and Development Strategy (MGDS II), increasingly challenging. This notwithstanding, considerable progress has been made in improving social indicators in health and education. My authorities remain committed to achieve macroeconomic stability, reduce poverty, and attain sustainable and inclusive growth.

Recent economic developments, macroeconomic outlook and policies

3. In early 2015, while fiscally adjusting to the loss of public resources through theft, which led to the suspension of donor budget support, the economy was hit by an unusual combination of heavy floods followed by drought. This resulted in an overall decline in agricultural output, with maize harvest declining by about 30 percent. The decline put an estimated 2.8 million persons from 25 of the 28 districts in the country at the risk of food insecurity. A response in terms of food distribution started in August this year in districts that were affected by floods and in October, again this year, for the ones affected by drought. The response is expected to continue till March 2016. The floods also disrupted energy generation and damaged some roads. Consequently, real GDP growth has been revised downwards to 3 percent from an earlier estimate of 5.7 percent.

4. Inflation has remained above 20 percent since June 2015. However, an upward trend set in much quicker in the year, driven by rising food prices on account of the decline in maize output and depreciation of the Malawi kwacha. Thus, year-on-year inflation reached 24.7 percent in October 2015, from 22.2 percent in July 2015.

5. Growth in 2016 is estimated at 4.5 percent. This assumes normal weather conditions as the forecasted “El Niño” phenomenon could seriously affect agricultural production. Besides agriculture, other sectors driving growth include construction, distribution, and the wholesale and retail sectors. In the medium term, growth is expected to pick up to about 6 percent while the external current account deficit is projected to be stable at around 8 percent. Resumption of uranium production in the medium term is expected to boost growth further. Inflation is projected to moderate in 2016, supported in part by tight fiscal and monetary policy stance.

Fiscal and public financial management

6. Fiscal adjustment has been challenging due to, in part, the need to address the food security situation to complement the humanitarian assistance received from the international community, and the need to recruit teachers and doctors. This recruitment and the granting of a higher than budgeted for general salary increase, to avoid continued disruptions of public services following industrial actions, led to overspending on the wage bill. As a result, the authorities implemented corrective measures, including expenditure cuts, in the first half of the 2015–16 fiscal year to partly offset the slippages. My authorities are committed to restoring macroeconomic stability and to take the necessary fiscal measures. In this connection, further expenditure cuts have been effected and will be tabled in Parliament during the Mid-Term Budget Review Session to be held in February 2016. The cuts have affected domestically financed investment and goods and services and preclude any increases to net domestic financing and emergence of domestic payment arrears. These have been carefully effected to safeguard allocations to social spending and consolidate the positive progress achieved this far.

7. In addition, a comprehensive payroll audit, which is expected to result in elimination of ghost workers, is currently underway. The authorities have, in the meantime, communicated measures to strengthen payroll management, and payment of salaries is now contingent upon submission of the required documentation, including Staff Returns. They are confident that these measures are sufficient to meet the end-December 2015 ECF program targets and to complement monetary policy actions in reducing inflation.

8. My authorities would like to highlight some progress that has been achieved in public finance management reforms (PFM), including: rationalization of government bank accounts at the Reserve Bank of Malawi (RBM); incorporation of main government bank accounts into IFMIS; and development of a more comprehensive strategy for resolving the problem of bank reconciliations. Most of the backlog in bank reconciliations will be processed by private accountants and auditors hired by the Auditor General, and verified by the Accountant General's Department (AGD). The AGD is closely monitoring reconciliations for the current financial year and submissions from the MDAs have significantly improved.
A multi-stakeholder technical committee is in place to monitor progress while Controlling Officers have now explicitly been charged with improving financial discipline within spending units; and independent audit committees, responsible for reviewing audit matters presented by internal and external auditors, have been established. Furthermore, with effect from January 2016, monthly funding to MDAs will be contingent upon their submission of (a) Expenditure Returns; (b) Revenue Returns; (c) Commitment Returns; (d) Bank Reconciliation returns; and (e) Staff Returns. These requirements are within the provisions of the Public Finance Management Act (PFMA).

Monetary and exchange rate policies

9. The RBM is committed to continue using policy instruments at its disposal to stabilize monetary conditions. In November 2015, it raised the policy rate by 200 basis points to 27 percent in a move to tame inflation. With respect to the monetary policy architecture,

the RBM submits that aligning the policy rate with Treasury bill rates is not a daily operational objective, given the oligopolistic structure of the interbank market. The fiscal costs of aligning the interbank rate with the policy rate outweigh the monetary policy benefits and cannot, at the moment, be justified as a daily operational objective.

10. The exchange rate against the United States dollar weakened from end-June 2015 and temporarily stabilized at the beginning of September 2015, but continues to weaken. These developments, in part, reflect the strengthening of the dollar against most major currencies and excess demand for foreign exchange to finance imports. As communicated during consultations, my authorities agree with the assessment on the exchange rate valuation and reiterate their commitment to maintaining exchange rate flexibility, with interventions being limited to smoothening market volatility.

Financial sector

11. In January 2014, Malawi migrated to Basel II standards to strengthen financial sector stability. Banks that could not meet the new capital requirements had to augment their capital. In the process, two weak banks with significant state-shareholding were sold and are being recapitalized. The revision of the RBM Act further strengthened the monetary policy framework. In addition, the RBM took steps to strengthen the soundness of the financial sector, including the introduction of new provisioning directives to address low provisioning rates on NPLs, which have since decreased from 16 percent of total loans and advances in June 2014 to 14 percent in June 2015. Overall, the banking sector remains well capitalized, profitable and liquid.

12. Recent stress tests, however, confirmed that credit risk stemming from high exposure to large borrowers poses a significant threat to the banking system. As noted in the report, my authorities recognize that credit risk and particularly concentration risk from exposure to large borrowers remain the largest threat to financial sector stability. It should be noted that the concentration risk will remain a feature of the financial system for some time, given the role of large conglomerates in the economy and limited access to both long-term external and domestic financing. The RBM is committed to continued stress testing, enhancing supervision, and enforcing compliance with prudential norms. In addition, they are pursuing efforts to further deepen the financial sector and foster financial inclusion.

Structural Reforms

13. A critical structural issue to support economic activity in the country is the reliability of fuel supply in all parts of the country. Therefore, with the key objective of guaranteeing security of supply of fuel in the country, my authorities have approved a set of reforms pertaining to liquid fuels and gas within the energy sector. These include (i) allowing the state-owned National Oil Company of Malawi (NOCMA) to participate in the importation of petroleum; (ii) introduction of the dry port concept for running the strategic fuel reserves, with an added advantage of easing tax collection; and (iii) introduction of the fuel bulk procurement system for the country which is expected to lower procurement prices through economies of scale. The automatic fuel pricing mechanism will continue.

14. In a bid to diversify agricultural exports, the government with private sector partnership is investing in commercial agriculture through the Greenbelt Initiative to produce sugar, ethanol and rice, which will also involve the participation of small scale commercial farmers. Another upcoming investment along the same concept is the Shire Valley Irrigation Project. It is expected that these projects will go a long way to reduce poverty and boost export volumes. Within this sector, the Farm Inputs Subsidy Program (FISP) will also be reformed to enhance efficiency of expenditure without compromising food security. Consultations with staff and other key stakeholders are underway to explore options that are expected to create fiscal space for other investments.

15. The importance of improving the business environment cannot be overemphasized and efforts in that respect continue, particularly in improving energy and transport infrastructure. A milestone reform has been the establishment of a one stop investment window at the Malawi Investment and Trade Centre (MITC).

Conclusion

16. My authorities reiterate their commitment to restoring macroeconomic stability, reducing poverty and attaining sustainable and inclusive growth. In this regard, they will implement tight fiscal and monetary policies needed to place inflation on a downward declining trajectory; and continue with structural reforms, including improving the business environment. They also commit to accelerate the pace of the PFM reforms. The broad public sector reforms to bring efficiency and improve public service delivery are also on going.
In line with the MGDS priorities, the authorities will pursue infrastructure investments in energy, transport, water, tourism, agriculture and also press on with efforts in export diversification. Investments in social infrastructure and provision of related service are also key priorities for the government.