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FIFTH AND SIXTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR WAIVERS FOR NON-OBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, MODIFICATION OF PERFORMANCE CRITERION, AND REPHASING OF DISBURSEMENTS—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI

In the context of the Fifth and Sixth Reviews Under the Extended Credit Facility Arrangement, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 23, 2015, following discussions that ended on December 18, 2014, with the officials of Malawi on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on March 5, 2015.
- A **Debt Sustainability Analysis** update prepared by the staffs of the IMF and the World Bank.
- An **Informational Annex** prepared by the staff of the IMF.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for Malawi.

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

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

*Also included in Staff Report

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

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March 5, 2015

FIFTH AND SIXTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR WAIVERS FOR NON-OBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, MODIFICATION OF PERFORMANCE CRITERION, AND REPHASING OF DISBURSEMENTS

KEY ISSUES

The IMF has been supporting Malawi under an Extended Credit Facility (ECF) arrangement. A 36 month, SDR 104.1 million (150 percent of quota) Extended Arrangement under the ECF was approved by the Executive Board on July 23, 2012 and the Third and Fourth reviews were concluded on January 17, 2014. A total of SDR 52.06 million has been disbursed to date. The sixth and seventh tranches totaling SDR13.02 million will be available upon the completion of the Fifth and Sixth review.

The "cashgate" scandal that came to light in October 2013 has had major political and economic consequences. While President Banda's government initially responded with strong actions, allowing the third and fourth ECF program reviews to be completed in January 2014, these efforts were not sustained. In the run up to the presidential and parliamentary elections in May 2014, further governance concerns emerged and macroeconomic policies drifted off track. As a result, donor budget support remained suspended, resulting in increased recourse to domestic financing, monetization of the deficit, and the emergence of domestic payment arrears. As confidence waned, the exchange rate depreciated further and inflation became entrenched in the range 20–25 percent.

Reflecting these developments, program implementation was uneven given external financing shortfalls with several performance criteria not being observed. Three out of seven performance criteria for the fifth review were not met, including the continuous performance criterion on the contracting of non-concessional external loans. For the sixth review, while the end-June 2014 target for international reserves was met, several other quantitative targets were not observed and implementation of a few structural benchmarks set at the time of the third and fourth reviews was delayed.

The new authorities are firmly committed to the core policies and objectives of the original ECF-supported program. In particular, they have confirmed their commitment to the flexible exchange rate regime and the automatic fuel pricing mechanism, which have underpinned economic recovery since 2012. They recognize that attainment of single digit inflation and increasing international reserves remain critical objectives. Restoring fiscal discipline is key to achieving these goals, but faces major challenges from ongoing shortfalls in external financing.

Program discussions focused on key policy actions to address these challenges and bring the program back on track. These include (i) fiscal adjustment to ensure that the budget for FY2014/15 can deliver on its objectives; (ii) PFM reforms to address weaknesses revealed by "cashgate" and restore confidence and trust in the budget process; (iii) monetary policy measures needed to rein in inflation; and (iv) reforms to strengthen the regulatory framework for the financial sector. The authorities have taken strong prior actions in all these areas to demonstrate their ownership of the program and staff supports their request for completion of the fifth and sixth reviews.

Approved By
David Owen (AFR) and Mark Flanagan (SPR)

Discussions for the fifth and sixth reviews were held in Lilongwe during October 29—November 12 and December 10–18, 2014. The two missions were led by Mr. Williams (AFR). Other members of the mission team were Messrs Nsengiyumva and Wu (both AFR), Mr. Peralta-Alva (SPR), Ms. Sin (FAD) and Mr. Oestreicher (resident representative). Mr. Tucker (OED) participated in the discussions in November. The missions met with President Peter Mutharika, Ministers 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

A. Fiscal Scandal and its Aftermath

1. The discovery in October 2013 of a large theft of public funds, dubbed the "cashgate" scandal, exposed significant deficiencies in Malawi's fiscal systems (MEFP, ¶3, ¶4, and ¶14). President Joyce Banda's government responded quickly by launching a forensic audit and developing a short-term action plan of corrective measures in consultation with development partners (Appendix I). This allowed for completion in January 2014 of the delayed third and fourth reviews of the arrangement under the Extended Credit Facility (ECF). An interim audit report was issued in February 2014 and a final report was made public in October. In addition to providing details of the illicit transactions uncovered (MK20 billion or US$45 million), the report also provided broader insights into the deficiencies of public financial management (PFM) systems, including serious procurement-related problems.[1] While there was an expectation that with sufficient progress budget support would resume, this has yet to fully materialize.

2. The scandal had major political and economic repercussions. Public concerns about governance were compounded in early 2014 by questions about the use of proceeds (US$15 million) from the sale of the presidential jet in 2013 to service a non-concessional loan ($145 million, not previously reported to staff) contracted in October 2013 to purchase military equipment. As the May 2014 presidential, legislative and local elections approached, and the impact of the lost budget support intensified in the second half of the fiscal year, policy discipline lapsed somewhat. Macroeconomic policies went off track, with monetary financing of the fiscal deficit, exchange rate depreciation and continuing high inflation. Against this background, President Banda and her party lost the May elections, and a new government under President Peter Mutharika came to power.

3. The new government committed itself to rebuilding trust in public institutions and correcting macroeconomic imbalances, in order to set the country on a path to sustainable and inclusive growth. It also signaled its intention to do this by taking steps to bring its Fund-supported program back on track. Nonetheless, facing huge challenges, it has taken time to address the underlying problems, resulting in delays to the fifth (end-December 2013 test date) and sixth (end-June 2014 test date) program reviews.

4. Staff held discussions with the new authorities commencing in July 2014. These were geared towards ascertaining their commitment to the objectives of the ECF-arrangement, assessing progress made in addressing weaknesses in PFM exposed by the "cashgate" scandal and reaching understandings on policies to stabilize the economy including advice on the parameters underpinning a revised budget. The new authorities felt strongly that the previously-developed

[1] These were referred to as "out of scope" transactions, as they were not part of the auditors' remit to investigate cashgate transactions.

action plan to address PFM weaknesses was not sufficiently focused and prioritized, and they worked closely with an IMF Fiscal Affairs Department (FAD) technical assistance (TA) mission to develop a more focused medium-term plan. Following review discussions in November and December, the authorities have implemented key prior actions in the areas of PFM, monetary and financial policies. They complied with most end-January 2015 informal macroeconomic targets which were set during the December 2014 mission, thereby demonstrating strong ownership and forming the basis for renewed engagement.

5. Progress has been made in implementing the short-term action plan adopted in the aftermath of cashgate (MEFP, ¶3, ¶14, and ¶15, and Appendix I). There has also been better coordination among the Anti-Corruption Bureau, Financial Intelligence Unit, the Malawi Revenue Authority and the Financial Fraud Unit of the Malawi Police Force in prosecuting the case files arising from the forensic audit report (Box 1). These efforts have been bolstered by technical assistance from the U.K. Crown prosecution service in assessing the quality of background evidence and asset recovery (MEFP ¶14). "Out of scope" transactions by the military and police that were identified by the final forensic audit report will be addressed through audits (MEFP ¶15). In addition, procurement practices across the public sector have been harmonized and the U.K authorities are providing bilateral assistance on the treatment of sensitive procurements by the military.

RECENT DEVELOPMENTS AND PROGRAM IMPLEMENTATION

A. Recent Economic Developments

6. The cashgate scandal significantly damaged Malawi's economic outlook. In response to the scandal, donors suspended budget support. The sudden withdrawal of donor assistance relative to the program (5½ percent of GDP in FY13/14) and the inability of the authorities to stay within budget limits resulted in the program going off track.

Box 1. Cashgate Accountability

The authorities are actively pursuing prosecutions arising from the "cashgate" scandal.

- To date there have been five convictions and lengthy prison sentences for theft and money laundering and some recovery of assets (MK 183 million). In addition a military officer has been arrested in connection with so called "out of scope" (i.e. not cashgate-related) transactions associated with military procurements that were identified in the final forensic report.
- The authorities' are seeking convictions from the 53 case files derived from the final forensic report, with particular focus on large sums. They also intend to pursue prosecutions based on contraventions of section 88 of the PFM Act governing offences and discipline.

7. Against this backdrop, growth has held up but inflation has remained very high, while policies have proved challenging to implement (Figures 1–3).

- Growth has nonetheless proved resilient so far, despite the shocks to confidence and policy slippages. Preliminary estimates indicate that real GDP growth was close to 6 percent in 2014, with strong contributions from the agriculture, wholesale and retail trade, and information and communication sectors. The ready availability of foreign exchange and fuel, as a result of policy reforms introduced in May 2012, has supported the expansion of economic activity. Despite the humanitarian toll, the macroeconomic impact of recent floods appears to be limited as only about half of one percent of arable lands was affected, although hydro-electricity generation was disrupted[2].

- Inflation has remained stubbornly high (averaging 23.8 percent in 2014), in part reflecting loose and accommodative monetary policy. In the absence of donor budget support, higher-than-programmed domestic financing of the deficit (5½ percentage points of GDP) in FY13/14 and high liquidity levels from largely unsterilized foreign exchange purchases during the tobacco season, fueled inflation expectations. More recently, a hike in the policy rate by 250 basis points to 25 percent in November, 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, contributed to tightening liquidity and stabilizing the currency. Elevated inflation levels have triggered demands for wage increases by some public sector institutions but to date the authorities have largely held their ground.

- The implementation of fiscal policy was difficult given shortfalls in external financing. Shortfalls in external financing led to increased recourse to domestic financing and the emergence of domestic payment arrears in FY2013/14. In addition, there were arrears from previous years which were being re-audited and verified to ensure their legitimacy and cross-referencing with individuals and entities identified in the forensic audit report[3]. As a result, public debt has risen sharply since end-2012, by 18.6 percentage points, to 75.8 percent of GDP by end-2014. In a bid to reduce the costs of servicing domestic debt, in December, the authorities restructured some kwacha-denominated domestic debt (amounting to 6 percent of GDP) by selling it to PTA bank—a regional development bank—for US$250 million. This operation lowered interest costs by 1000 basis points on the affected stock of debt and, as repayment will be made in local currency, significantly boosted official reserve cover.

- The current account deteriorated in 2014, mainly reflecting the large drop in official transfers. An improvement in the merchandise deficit by 2 percentage points to about 10½ percent of GDP owing to strong growth in traditional exports was more than offset by the sharp decline in net

[2] The number deaths and displaced persons are estimated at 104 and 230,000 respectively. The number of displaced persons represented 2 percent of the population in affected districts. The authorities are implementing a recovery program with assistance from donors.

[3] Arrears from FY13/14 and those that accumulated from previous years amounted to 8 percent of GDP.

official transfers by 6.6 percentage points of GDP. As a result the current account deficit (including net official transfers) widened by 3¼ percentage points to 5.1 percent of GDP and the exchange rate depreciated by 15 percent over the year, punctuated by periods of large volatility[4]. The proceeds from the domestic debt restructuring and purchases of foreign exchange on the domestic market during the tobacco season were used to bolster reserves, which rose to 2.9 months of imports at end-2014. This helped to restore confidence in the kwacha.

B. Performance under the Program

8. Several quantitative targets for the fifth review (end-December 2013 test date) and for the sixth review (end-June 2014 test date) under the program were missed (Tables 9 and 10).

- For the fifth review, one out of the three periodic performance criteria was not met, i.e. the ceiling on net domestic assets of the central bank (RBM).

- For the sixth review two out of the three periodic PCs were not met. While the PC on net international reserves was observed comfortably, the PCs on net domestic assets (NDA) of the RBM and net domestic borrowing (NDF) by the government were missed by substantial amounts.

- For both reviews two continuous performance criteria were not met, i.e. the ceiling on new non-concessional external debt maturing in more than one year and the ceiling on non-accumulation of external payments arrears. The ceiling on new non-concessional external debt was missed due to the contracting of three non-concessional loans: (i) the contracting in October 2013 of a medium-term non-concessional supplier's credit for military equipment; (ii) the contracting, in April 2014, of a supplementary loan for the rehabilitation of an inter-city road, and (iii) the contracting in February 2015 of a loan for the construction of a cancer treatment center. The ceiling on non-accumulation of external payments arrears was missed due to the accumulation of arrears on the supply credit for the military equipment.

- For both reviews, indicative targets for reserve money were missed, reflecting the unsterilized build-up of international reserves (NIR) and increased recourse to central bank financing of the budget. In addition, indicative ceilings on social spending were missed by a maximum of 4 percent due to external financing shortfalls.

9. Progress in the implementation of structural benchmarks set at the time of the third and fourth reviews was uneven (MEFP ¶13 and Table 13). Most of the PFM-related benchmarks were not met, as these reforms were overtaken by the immediacy of taking short-term corrective actions (¶1). The critical reforms required to address weaknesses in PFM systems were therefore set

[4] The kwacha depreciated by 22 percent between September and November 2014 reflecting seasonal shortages in foreign exchange and economic uncertainties.

as prior actions to complete the current reviews (Table 14). Similarly a key financial sector reform—submission of the Banking and Financial Services Acts to parliament—that was pending was set as a prior action. In the area of monetary policy, amendments to the RBM Act limiting credit to government were a prior action for completing the reviews.

MACROECONOMIC OUTLOOK AND RISKS

10. The macroeconomic outlook, while challenging, hinges on the authorities' recommitment to the core polices and original objectives of the program (MEFP ¶2 and ¶18). These comprise the flexible exchange rate regime, the automatic fuel pricing mechanism, the attainment of single digit inflation by 2016 and reaching a reserve cover of at least three months of imports. Real GDP growth is projected to remain in the 5½–6 percent range, helped by a more stable policy environment, ongoing public investment in infrastructure and efforts being made to improve the business environment. Headline inflation is expected to decline to low double digits by end-2015 through a tighter stance of monetary policy and favorable international prices for food and fuel products. Helped by lower world oil prices, the current account deficit is expected to narrow from 5 percent of GDP in 2014 to under 3 percent of GDP in 2017 as nontraditional exports rebound over the medium-term, imports moderate following earlier surges associated with large public projects, and donor flows gradually recover, albeit not to previous high levels.

11. A number of downside risks remain. These could arise from capacity and institutional weaknesses in policy design and implementation, the absence of a recovery in donor financing, slower-than-expected growth in trading partners, or a possible deterioration in social conditions. In particular, a slower-than-expected disinflationary process could trigger further demands for wage increases. Weak international prices for tobacco could pose a risk but could be partially offset by lower oil prices. Adverse weather conditions continue to pose a significant risk because of the country's reliance on rain-fed agriculture. The authorities noted that should these risks materialize, spending would have to be reprioritized and that the flexible exchange rate would serve as a shock absorber.

POLICY DISCUSSIONS

12. The authorities reiterated their commitment to the policies and objectives of the original program including containing public expenditures within available resources, bringing inflation back to single digits and increasing reserve cover to at least three months of imports (MEFP, ¶2 and ¶18). Their overriding goal in the near-term is to stabilize the macroeconomic situation, regain firm control over their fiscal systems, and safeguard the stability of the financial sector. Achieving these near-term goals is expected to encourage growth-promoting investment, foster private sector confidence, and address Malawi's pressing development needs in the years ahead. In order to achieve these goals, the arrangement would be extended by 6 months. Given the passage of time since the last Board meeting, informal targets were set for end-January on net domestic assets of the central bank, gross international reserves and net domestic financing of the government to anchor polices. Two of three targets were met, gross international reserves and net domestic assets of the central bank. Net domestic financing was missed by (0.7 percent of GDP) on account of shortfalls in donor dedicated grants (1.2 percent of GDP) for social protection in health, education, and agriculture sectors and some outlays in response to the floods.

13. Discussions focused on key near-term program issues and policy measures needed to achieve the objectives of the original program. The macroeconomic framework was anchored on a policy mix that provides adequate fiscal domestic financing while ensuring a tighter overall monetary stance to tackle inflation. The continued commitment to the floating exchange rate will help the economy to adjust to external shocks. Key issues discussed include (i) ensuring that the FY2014/15 budget can deliver on its objectives, given unanticipated risks, potential shortfalls in budgeted external financing and the need to limit recourse to domestic financing; (ii) managing the fall-out of the fiscal scandal by designing upfront policy actions that restore confidence in PFM and the budgetary process ; (iii) tightening the monetary stance to rein in inflation while avoiding a squeeze on private sector credit and growth; and (iv) safeguarding financial sector stability by strengthening the regulatory framework.

A. Preserving the Objectives of the 2014/15 Budget and Mitigating Risks

14. The need to preserve debt sustainability and reduce inflation continues to anchor medium-term fiscal policy. Malawi's debt has risen sharply (¶7) underscoring the need to place limits on the degree of domestic financing. The domestic fiscal balance is projected to narrow over the medium term—from 8 percent of GDP in FY13/14 to 4.1 percent in FY14/15 and under 2 percent by the end of the program period—which will be critical in placing public debt on a downward trend (Table 2b). While the program was initially based on zero domestic financing, this became untenable in the face of continued shortfalls in external financing and uncertainties regarding the resumption of donor support. Against this background, the program allows some limited domestic financings that is consistent with inflation targets and conservative assumptions on donor support.

15. The FY14/15 budget adopted by Parliament in early September 2014 was broadly in line with the program, but several factors threatened its implementation. The budget was based on an overall deficit (including grants) of 5.4 percent of GDP (down from 8.7 percent in FY13/14), of which 4.6 percent was expected to be covered by external financing and 0.8 percent by net domestic borrowing. The large fiscal adjustment planned for FY14/15 was mostly accounted for by a large reduction (over 5 percentage points of GDP) in current expenditures, with development spending protected. Staff identified four major factors that needed to be addressed in order for the budget to meet its objectives. These comprised (i) higher-than-budgeted domestic interest expenses; (ii) further shortfalls in external financing (available budget support is expected to amount to only half a percentage point of GDP, compared with over 6 percent in FY12/13); (iii) cost overruns in the administration of the fertilizer scheme; and (iv) the need to regularize past payment arrears. In order to reflect these developments in a revised budget, staff and the authorities identified significant additional expenditure cuts (mostly domestically financed capital), but also agreed that a moderately higher overall deficit would be more realistic (5.9 percent of GDP), with somewhat higher domestic financing (1.9 percent of GDP—still 4 percentage points less than in the previous year). Social spending in the FY14/15 budget (12.6 percent of GDP) is 21 percent higher than in the FY13/14 budget (Tables 10 and 12) with allocations to health, education and the fertilizer subsidy scheme accounting for 95 percent of outlays.

16. Staff discussed with the authorities the issue of regularizing the large stock of domestic arrears (MEFP, ¶23). Once verified and certified by the National Audit Office, arrears would be settled partly in cash and through the issuance of promissory notes in three tranches of maturities varying from one to three years. As the audited stock of arrears represents legitimate government liabilities, staff supported their regularization as necessary to restoring fiscal credibility by paying regular suppliers with recent arrears through cash within the limits of the budget and older arrears through securitization. Staff underscored the critical importance of strengthening commitment controls and holding controlling officers accountable in order to prevent the emergence of new domestic arrears. To this end, envisaged measures included the incorporation of all government accounts into the Integrated Financial Management Information System (IFMIS) to facilitate account reconciliation and to strengthen commitment controls and the periodic preparation of reports on stocks and flows of arrears (Tables 14 and 15)

B. Strengthening PFM Systems in the Wake of the Cashgate Scandal

17. Prior to the "cashgate scandal" Malawi's PFM reforms were consolidated under a single framework aimed at strengthening the institutional setting. This comprised, a three year program (2011–14) with a total of 9 components covering the entire PFM cycle: planning, resource mobilization (including domestic and external resources), budgeting, procurement, accounting and financial management, cash and debt management, para-statal financing, monitoring and reporting, and external auditing. This program was complemented by donor engagement under the common approach to budget systems which instituted a program of monitoring progress made in implementing PFM reforms. While progress was made under cash management, budget execution and commitment controls, inadequacies of the IFMIS, and account reconciliations were exposed by the scandal.

18. Against this backdrop, understandings were reached with the new authorities on the sequencing of further reforms to bolster financial control and accountability. Discussions were guided by the findings and recommendations of the November 2014 FAD mission on strengthening PFM systems and the final forensic audit report. A number of recommendations of the FAD mission were incorporated in the program as prior actions or structural benchmarks in the PFM area (Table 14). The FAD mission identified the fragmentation of the accounting framework as a notable source of the weak control and accountability of the budget process. To address this shortcoming, two key prior actions that would reinforce commitment controls, facilitate the reconciliation of accounts and improve cash management were seen as critical to jump start the PFM reform strategy. The strategy that was prepared with IMF technical assistance is summarized in Box 2. The authorities have adopted the new PFM strategy following consultation with key stakeholders, including donors. The adoption of the new PFM strategy and its subsequent implementation was a prerequisite for donor resumption of budget support.

Box 2. Malawi Public Financial Management Strategy

The PFM strategy prioritizes reforms needed to address control and capacity weaknesses. It builds on gaps identified in the forensic audit and IMF TA reports and focuses on the following areas:

- ***Improved fiscal reporting***: Expands coverage of IFMIS through the incorporation of all government accounts. Desired outcomes are improvements in data reliability, trial balance reports and monitoring of budget execution reports with the objective of improving integrity and transparency of accounting and financial data.
- ***Treasury cash flow management***: Focuses on bank reconciliation through the rationalization of the number of government bank accounts. Enforcement of commitment controls through the IFMIS purchase order module, and subjecting the commitment process to internal audit in ministries is key to respecting budget allocations.
- ***Auditing:*** Reorients internal and external audit to focus on auditing key controls and reports, bank reconciliation, summary bank reports and IFMIS internal controls. The strategy envisages revising the functional reporting lines of internal audit to increase its effectiveness and hiring of international audit firms to address the existing capacity gaps in the auditing function.
- ***Strengthening the overall PFM control environment:*** Aims to improve the levels of technical and professional competence amongst staff engaged with financial management responsibilities. The strategy provides for awareness and instructional workshops, better access to the PFM legal framework, continuous capacity building and rationalizing the sanction regime and instituting mechanisms for effective enforcement. Going forward human resource policies relating to government employees including the common accounting service will be reviewed to attract and retain professionally competent staff.

19. The sustained implementation of PFM reforms is critical to restoring confidence and trust in budgetary processes and demonstrating ownership. In this context, key structural benchmarks are embedded in the PFM reform agenda and action plan (Table 15) and encompass increased reporting and transparency. Given the PFM weaknesses highlighted in past IMF TA and the forensic audit reports, an assessment by an international auditing firm confirming the status of implementation of forensic audit report recommendations will be undertaken to evaluate commitment to the reform process. With donor assistance, an international auditing firm has been contracted to conduct forensic audits on IFMIS during 2009–13 (MEFP ¶4).

C. Reining in Inflation and Stabilizing Expectations

20. Placing inflation on a downward trend is key to anchoring expectations. The RBM sent a strong signal of its policy commitment during the last quarter of 2014 by raising its policy rate by 250 basis points to 25 percent and increasing the liquid reserve requirement on foreign currency deposits (MEFP, ¶7). These two measures had the effect of raising interbank and treasury bill rates which now stand at levels close to the policy rate. The combination of this policy change, and the significant increase in reserve cover from the transaction with the PTA bank, reversed speculative pressure against the local currency In response to the policy change, banks have unwound their dollar positions as demand for the kwacha has increased. Looking forward, the RBM intends to ensure that its policy rate remains above the rate of inflation and that interbank and Treasury bill rates stay positive in real terms. Maintaining attractive real returns on domestic assets is expected to firm up confidence in the kwacha, thus mitigating the seasonal depreciation pressure which has been a major source of inflation. In parallel, the RBM will improve its communication with market participants through announcements to convey its commitment to price stability and enhance the transparency and credibility of its monetary policy.

21. The authorities have taken steps to address fiscal dominance. The cancellation of the automatic conversion of overdrafts into government securities by the RBM was a key step towards managing government borrowing from the central bank (MEFP ¶13). In addition, amendments to the RBM Act were submitted to parliament imposing an upper bound on total government borrowing from RBM to 10 percent of the previous year domestic revenue in any given year (prior action). This will impose a tighter limit on government borrowing from the central bank and enhance the credibility of monetary policy as the previous limit was 20 percent of advances only and excluded other forms of credit[5].

22. The authorities reiterated their commitment to a flexible exchange rate regime. In this context, the central bank intends to intervene in the foreign exchange market mainly to manage excessive exchange rate volatility arising from the seasonal pattern of private foreign exchange inflows and the lumpy disbursement of external official flows. The recent augmentation of reserves and the projected gains from the upcoming tobacco buying season should provide sufficient cushion to allow achievement of both objectives.

23. Refinements in liquidity forecasting and management are envisaged to increase the effectiveness of the monetary transmission mechanism. A reduction in the lags in information flows on government's daily cash flows will facilitate day-to-day liquidity management and decisions regarding absorption of structural liquidity. Although the authorities have an adequate set of monetary policy instruments such as repos and reverse repos, these could be strengthened in the context of the floating exchange rate regime through better use of multiple indicators besides reserve money.

D. Safeguarding Financial Sector Soundness

24. Steps have recently been taken to strengthen the regulatory framework for the banking sector. Migration to Basel II directives became effective on January 1, 2014. The RBM raised Tier 1 and total capital requirement ratios to 10 percent and 15 percent from 6 percent and 10 percent, respectively. With Fund TA, prudential norms in the areas of asset classification, provisioning, and liquidity were improved. In addition, a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action against distressed banks was

[5] The 10 percent limit is also based on the model central bank law of the Southern African Development Community of which Malawi is a member.

adopted in 2014. Furthermore, as a prior action for the completion of the fifth and sixth reviews, amendments to the Banking and Financial Services Acts to align the legal framework for bank resolution more closely to international best practice have been submitted to Parliament.

25. Capitalization of the banking sector has improved with the introduction of minimum capital standards but some significant weaknesses remain (Table 5 and Figure 4). Official indicators show that all banks, except two now have higher capital adequacy ratios than required under the new Basel II standards. However, risk concentration is rising and loan quality deteriorating. The limited number of large borrowers in the economy has contributed to non-compliance with the risk concentration prudential norms by a number of banks. The large devaluation of the currency in May 2012 and the sharp shortfalls in external financing in 2013–14 have adversely affected banks balance sheets. The non-performing loans (NPLs) to gross loan ratio has increased sharply from 5 percent in early 2012 to about 16 percent in late 2014 reflecting shocks to the economy and the accumulation of government payment arrears. In order to address provisioning for NPLs, the authorities have issued in May 2014 a directive based on the Expected Recoverable Amount Method (ERAM) by imposing a provisioning rate that increases by 16.67 percentage points per quarter on NPLs past due after 90 days.[6]

26. The authorities remain committed to taking the appropriate steps to address risks posed by weaknesses in the financial sector. The strategy will encompass recapitalizing or intervening in weak banks and strengthening the regulatory and supervisory framework of the banking system. To enhance both on and off-site supervision, an external banking supervision advisor has been hired and commenced work in July 2014. In addition, the RBM stressed its commitment to closely monitor and enforce compliance with all prudential norms (MEFP, ¶28). Given shortcomings in the anti-money laundering (AML/CFT) framework identified by the forensic audit report, amending the AML/CFT Act, the Penal Code and the Corrupt Practices Act will address gaps and better align the regulatory framework with the Financial Action Task Force standards and the United Nations Convention Against Corruption (MEFP¶31 and benchmark).

27. Third-party diagnostic assessments of the health of the banking system were completed during 2014. These assessments covered verification of asset quality, liquidity, off balance sheet liabilities, analysis of profit and loss and assessment of the adequacy of regulatory capital. All major areas of concerns have been communicated by the RBM to the Board of Directors of each bank for action. Two weak banks were identified during the evaluation and the restructuring process has commenced for the weaker of the two banks, which envisages its sale or recapitalization (MEFP ¶26). The second bank has a significantly stronger capital position and will be addressed through a capital injection by shareholders.[7] In light of the findings of the assessments and in consultation with the Fund, the RBM intends to identify and design an appropriate strategy within the legal framework to address sector wide issues, particularly with regard to risk concentration,

[6] The provisioning rate for NPLs then becomes 100 percent 18 months after the 90 days.

[7] The contingent liabilities to the government of the two weak banks range between 0.4–0.6 percent of GDP.

recognition and provisioning of NPLs, and suitability of the legal and prudential frameworks, (MEFP ¶24; and structural benchmark).

E. Preserving Debt Sustainability

28. A new DSA undertaken jointly by Fund and World Bank Staff, indicates that Malawi remains at moderate risk of debt distress. Malawi's public and publicly guaranteed external debt continued expanding through 2013 and 2014 and is estimated to have reached 32.2 percent of GDP in present value terms by the end of 2014. It is expected to gradually decline thereafter. The resulting breach in the corresponding debt threshold (30 percent of GDP) is expected to be marginal and short lived. More important, this breach is due not to accumulation of new debt, but to the restructuring of existing domestic debt through a sale to a regional development bank, which was negotiated by the government of Malawi to lower debt service costs and to raise its international reserves cover (¶7). The strong depreciation of the kwacha during the fourth quarter of 2014, which has subsided, also played an important role in causing the breach in the PV of external debt to GDP threshold.

29. Domestic debt has risen sharply following the drop in external financing and the recognition of past domestic arrears. As a result total public debt is significantly above the recommended benchmark of 40 percent of GDP in present value terms. At end-2013, the present value of total public debt stood at 55.9 percent of GDP, and reached what is expected to be its peak of 60.6 percent at end-2014. Domestic debt as a share of GDP is projected to decline with fiscal consolidation and the maintenance of a positive primary balance.

30. Greater efforts are needed to safeguard debt sustainability. Staff underscored the need for bold actions to strengthen debt management in the near-to-medium term to ensure that total public debt remain sustainable. The authorities plan to achieve this objective through the Debt Management Committee (DMC), a senior body that has been resuscitated to act as an apex advisory board on public debt management. This will introduce greater oversight and constitute an improvement in current procedures involving document preparation by junior level staff that may not be empowered to pronounce on conflicts between the contracting of debt and program conditionality. In this capacity, it is envisaged that the DMC will be responsible for preparing an annual debt management strategy, as part of the annual budget process, and monitoring it throughout the year. It will be charged with reviewing and recommending debt financing options—such as maturity structure and type of instrument—and will also be responsible for examining each borrowing to ascertain its concessionality and to ensure debt sustainability (MEFP, ¶ 21).

PROGRAM ISSUES

31. The implementation of several prior actions was a pre-requisite for completing the fifth and sixth reviews (Table 14). Adjustments to the approved budget in order to align it with the program were implemented through the issuance of a circular to Cabinet with the new expenditure ceilings. Thus all Ministries and Development Agencies (MDAs) are aware of the new expenditure limits and can plan accordingly ahead of submitting a revised budget to parliament On the PFM front, two prior actions were introduced as critical first steps to improve cash management, accounting and reconciliation of accounts. Two other prior actions to enhance the effectiveness of monetary policy and promote financial stability comprised submitting to parliament legislative amendments to limit RBM's credit to government and to strengthen the regulatory framework of the banking system. In addition, while not a prior action, in November the authorities hiked the policy rate and issued the directive on the liquid reserve requirement to strengthen the policy mix geared to bringing inflation on a downward path. Informal quantitative targets for end-January 2015 on NDA, gross official reserves and NDF were also set to anchor monetary and fiscal policies, sustain a tightening of policies given the inflationary environment and improve reserve cover.

32. The authorities are requesting waivers for the non-observance of one periodic PC for the fifth review (end-December 2013 test date) and also for the non-observance of two periodic PCs for the sixth review (end-June 2014 test date). The ceiling on NDA of the RBM was not met in part because of the shortfalls in external financing. The PCs on (i) NDA of the RBM and (ii) government NDF were not met owing to continued difficulties in program implementation in the face of shortfalls in external financing and election uncertainties. An adequately financed budget and the implementation of PFM reforms (Box 2) are key to ensuring that future PCs are met. Given the suspension of budget support, the authorities' commitment to implement a revised budget based on more realistic domestic financing, placing limits on RBM financing and strengthening PFM frameworks represent important safeguards to keeping the program on track. In particular, better fiscal reporting, cash flow management, auditing, compliance and commitment controls as envisaged in the early implementation of the PFM strategy should help restore fiscal discipline.

33. The authorities are also requesting waivers for the nonobservance of the continuous PCs on the contracting of non-concessional external debt maturing in more than one year, and on the accumulation of external payments arrears for the fifth and sixth reviews. The ceiling on the accumulation of non-concessional debt maturing in more than one year was missed, due to (i) the contracting of a supplementary loan for the rehabilitation of an inter-city road, which became effective in April 2014, and (ii) the contracting of a loan for the construction of a cancer center in February 2015. With respect to the infrastructure loan, efforts to obtain better terms were unsuccessful, and so the authorities decided to go ahead with the loan on the grounds that it was critical to addressing Malawi's infrastructure gap, and to avoid accumulation of arrears to the contractor (MEFP, ¶10).) In staff's view, the deviation was minor (the loan amount was $4 million with a grant element of 28 percent), does not threaten achievement of program objectives and corrective actions have been undertaken (¶30). The loan for the cancer treatment facility, which would amount to US$13 million, has been negotiated with the OPEC Fund for International Development (OFID) and is at 29 percent grant element. The authorities have not been able to secure concessional funding for the center from traditional development partners. Given the loans size and its concessionality, the debt dynamics are not envisaged to worsen significantly nor persistently. Corrective measures have been undertaken to strengthen debt management (¶30).

34. The authorities are also requesting an extension of the arrangement and a rephasing of disbursements (LOI). Given the delays in program implementation over the past year, they request an extension of the arrangement by six months to May 22, 2016 and the rephasing of disbursements associated with the seventh and eight reviews. The sudden stop in donor support and lapses in policy continuity generated by election uncertainties and the transition to a new government necessitate an extension of the arrangement and re-phasing in order to achieve the objectives of the program.

35. Malawi's capacity to repay the Fund is adequate. The new disbursements under the ECF arrangement will have a negligible impact on debt and debt service ratios (Table 8) and Malawi's risk of debt distress is moderate. Nevertheless, there are risks which could negatively affect program implementation. Risks to the program could arise from policy slippages that could ensue from lack of ownership of reforms and weak capacity that could constrain their implementation. The adoption of prior actions in PFM, dovetailed with a long-term PFM advisor and Fund TA should help to build capacity, strengthen systems, and help in the timely identification of emerging risks.

STAFF APPRAISAL

36. The "cashgate scandal" damaged Malawi's macroeconomic outlook and led to the program going off track. Consequently, program performance was uneven with several performance criteria for the fifth and sixth reviews not being observed. Staff regrets delays in program implementation and missed opportunities arising from the scandal that led to the program going off track.

37. The new authorities confirmed their strong commitment to the core policies and objectives of the program. These include the flexible exchange rate regime, which has served as a shock absorber and facilitated adjustment to external shocks, and the automatic fuel pricing mechanism, which has ensured reliable supplies. These reforms have underpinned economic activity, which has proven to be resilient with real GDP growth rate holding up at around 5½-6 percent. Bringing inflation down to single digits will reduce uncertainty and improving reserves cover to three months of imports will bolster policy buffers.

38. The implementation of PFM reforms is indispensable to restoring confidence and trust in the budget process and a resumption of budget support. The large scale theft of public funds undermined the government's standing with the public and the donor community. Staff welcomes the authorities' strategy to strengthen PFM systems and the initial steps that have already been taken. Timely implementation of the remainder of the strategy, including recommendations of the forensic audit and subsequent verification are essential to demonstrate the government's commitment to addressing the impact of the fraud and ownership of the reform process. The sustained implementation of PFM reforms is critical to fostering full donor re-engagement.

39. Staff welcomes the RBM's commitment to tighten monetary policy as needed to place inflation on a downward path. Achieving single-digit inflation and raising foreign reserves cover to at least three months of imports, should be the main goals of monetary policy during the program period. Given inflation's persistence, it is imperative that the RBM remains vigilant and stands ready to further tighten monetary policy if inflationary expectations do not subside. Staff urges the timely adoption of amendments to the RBM Act, geared towards limiting fiscal dominance.

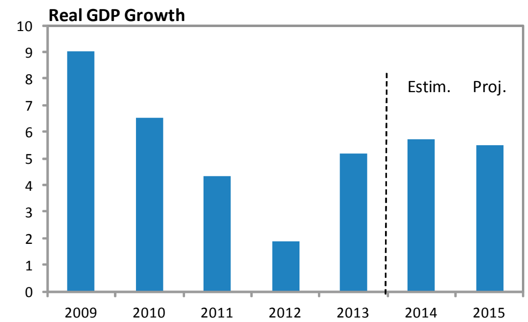
40. The authorities are encouraged to leverage the findings of the diagnostic reports on the health of the banking system to safeguard financial stability. Staff urges the authorities to enforce prudential norms and address weaknesses in the regulatory framework. To this end, the adoption by parliament of the Banking and Financial Services Acts and amending the anti-money laundering framework are critical additions to the authorities' policy toolkit.

41. Greater efforts are needed to strengthen debt management. Despite Malawi's classification of moderate risk of debt distress, public debt has risen sharply as a result of recent shocks. The authorities are encouraged to adopt a strong debt management strategy to ensure that total public debt is sustainable and the right balance of costs and risks is achieved. In this context, the debt management committee should be strengthened and given the necessary power to fulfill its mandate.

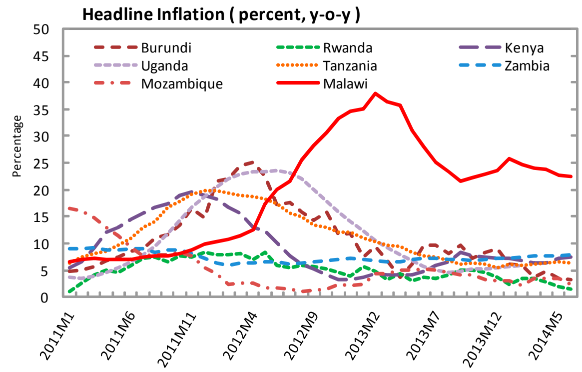
42. Staff recommends the completion of the fifth and sixth program reviews. This recommendation is based on strong policy implementation, including implementation of several prior actions since the new government took office as well as on the ambitious reform agenda articulated by the authorities in their MEFP. Staff also supports the authorities' request for waivers on missed PCs for the fifth and sixth reviews based on the strong corrective actions already taken. Staff further supports the extension of the arrangement, rephasing of disbursements, the modification of the continuous PC on new non-concessional external debt maturing in more than one year, and the establishment of performance criteria for end-June 2015 and end-December 2015.

Figure 1. Malawi: Recent Developments, 2009–15

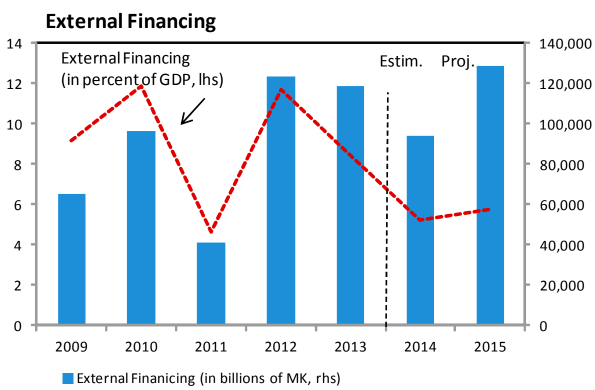
Economic activity remained resilient following policy reforms introduced in 2012.



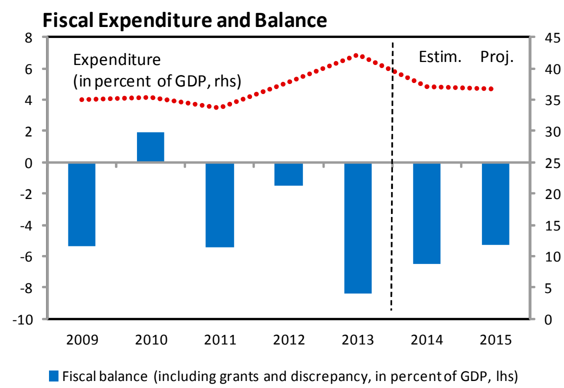
… while headline inflation remains stubbornly high compared to neighboring countries.



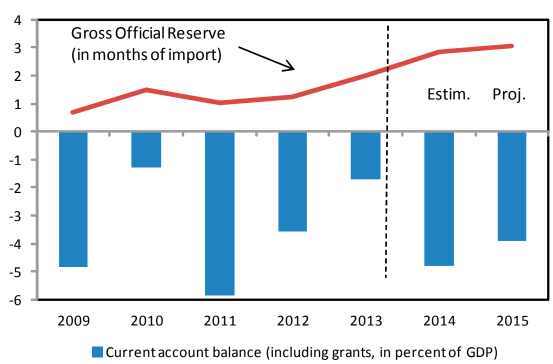
A shortfall in external aid emerged due to the public funds misappropriation scandal.



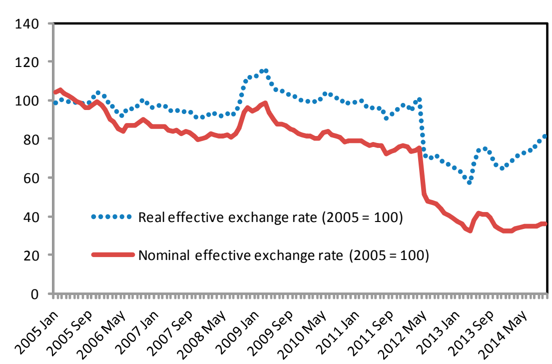
Spending has been contained, but the deficit is still worrisome.



The current account deficit increased due notably to the suspension in aid.

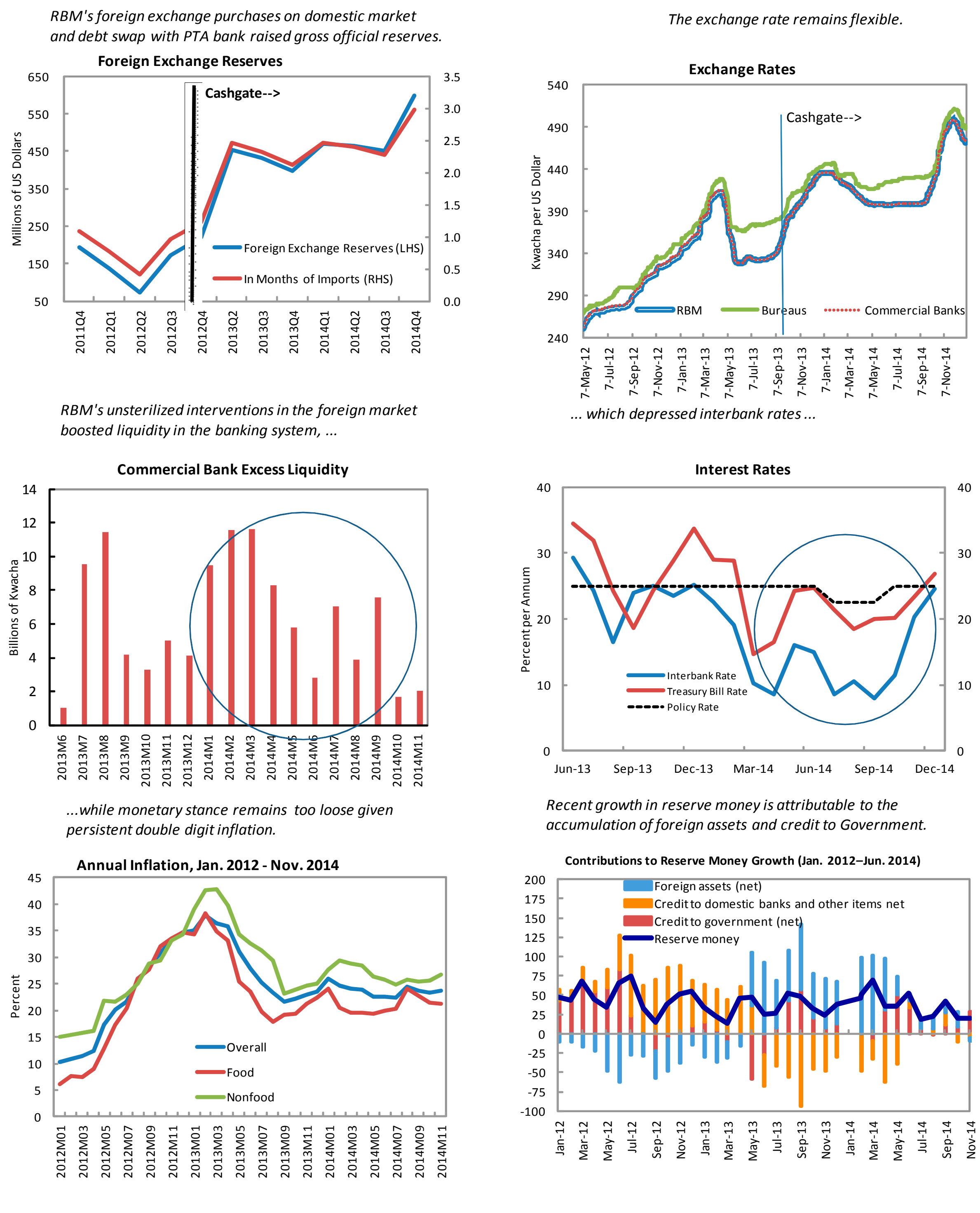


…while the REER appreciated, reflecting higher domestic inflation relative to trading partners.



Sources: Malawian authorities and IMF staff estimates.

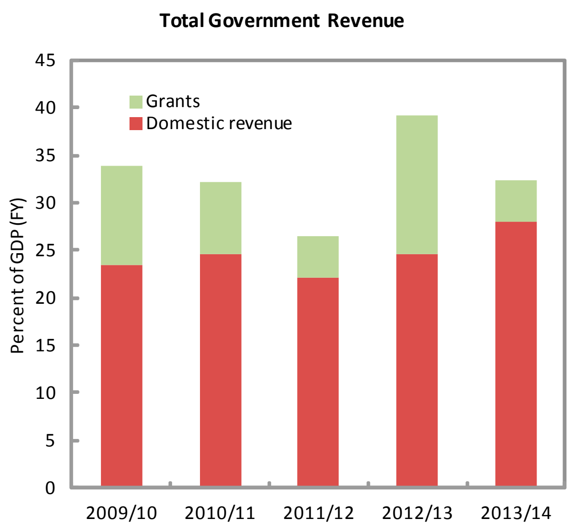
Figure 2. Malawi: Monetary Developments, 2011–November 2014



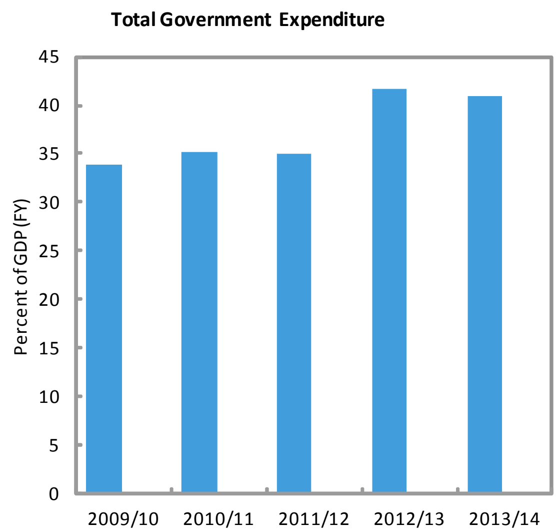
Source: Malawian authorities.

Figure 3. Malawi: Fiscal Developments, 2009–14

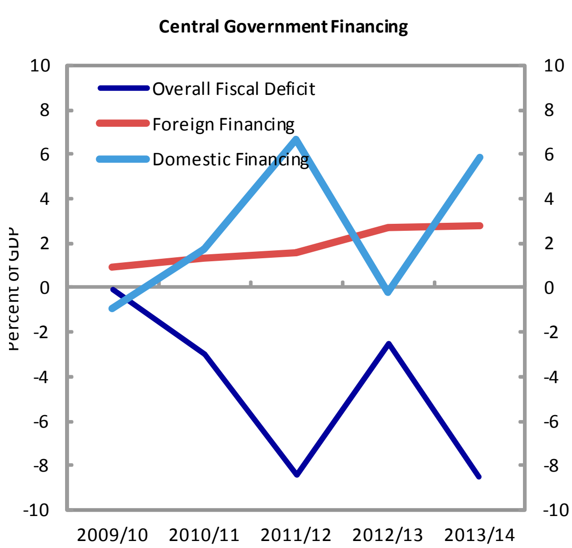
Domestic revenue remains buoyant but total revenue fell due to the drop in grants during FY2013/14 ...



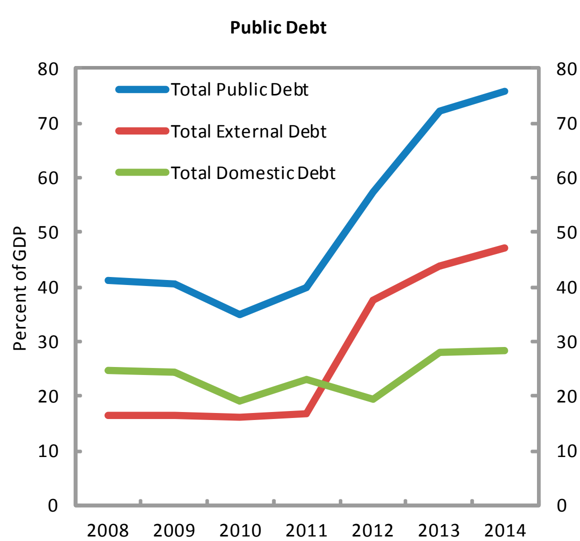
...while spending remained sticky.



This led to a widening of the fiscal deficit, which was largely financed by domestic borrowing



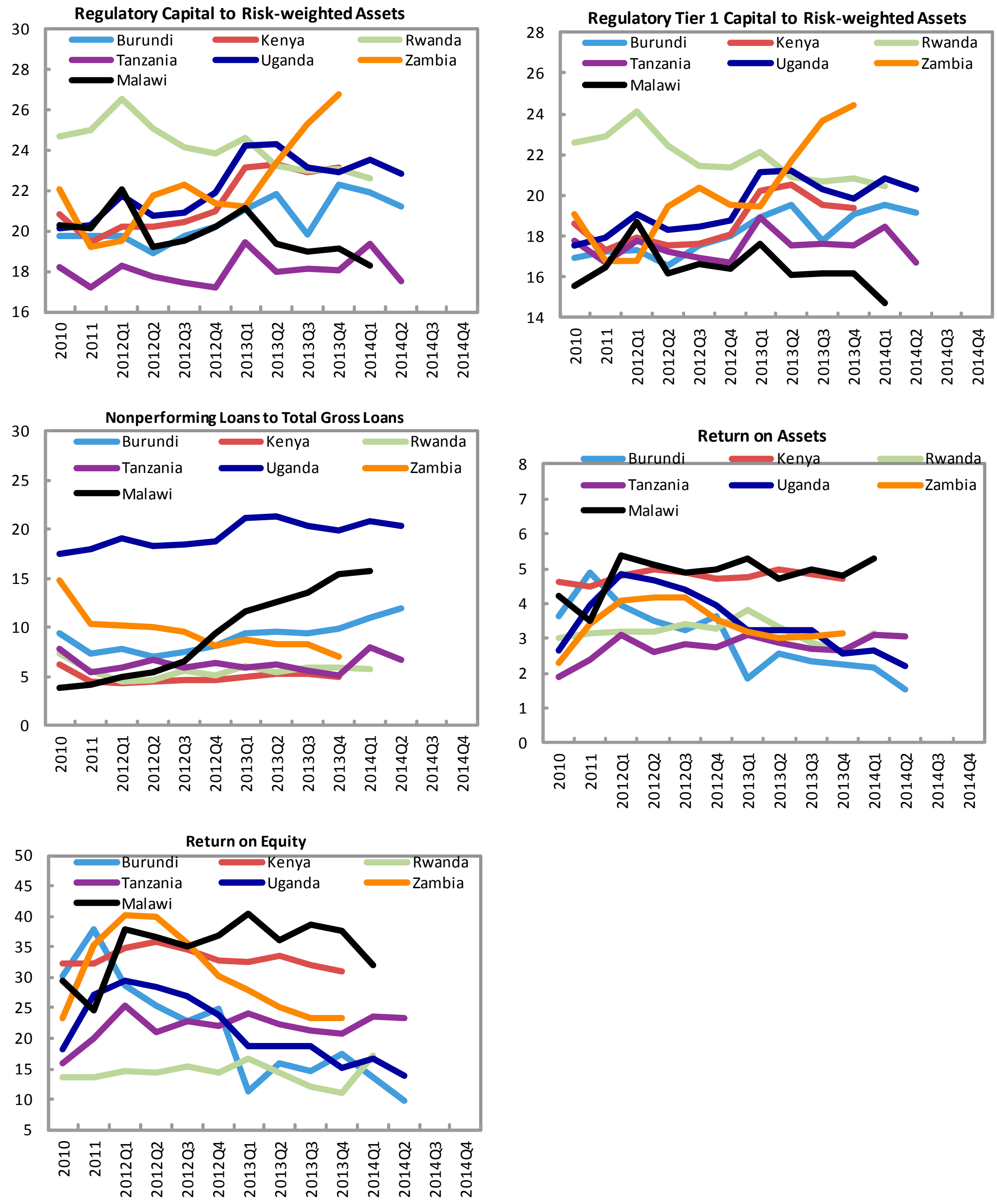
Domestic debt increased by 9 points of GDP in 2013 and is expected to stabilize at about 28 percent in 2014.



Sources: Malawian Authoroties and IMF Staff Estimates

Figure 4. Banking Soundness Indicators: Malawi Relative to its Neighbors, 2010–14

(Percent)



Sources: IMF's Data Base and Malawian Authorities

Table 1. Malawi: Selected Economic Indicators, 2011–17

25-Feb-15	2011	2012	2013		2014		2015	2016	2017
	Act.	Act.	Prog.[1]	Actual	Prog.[1]	Est.		Proj.	
National accounts and prices (percent change, unless otherwise indicated)									
GDP at constant market prices	4.3	1.9	5.0	5.2	6.1	5.7	5.5	5.7	6.0
Nominal GDP (billions of Kwacha)	881	1,057	1,412	1,415	1,744	1,809	2,224	2,556	2,893
GDP deflator	4.0	17.7	27.3	27.3	16.4	20.9	16.4	8.7	6.7
Consumer prices (end of period)	9.8	34.6	20.1	23.5	9.7	24.2	12.0	8.0	7.0
Consumer prices (annual average)	7.6	21.3	27.7	28.3	15.1	23.8	17.3	10.0	7.7
Investment and savings (percent of GDP)									
National savings	9.4	13.4	16.9	14.2	18.6	10.3	12.2	13.0	13.5
Gross investment	15.3	16.9	20.4	16.0	21.2	15.4	15.6	15.7	16.1
Saving-investment balance	-5.9	-3.5	-3.5	-1.8	-2.6	-5.1	-3.4	-2.7	-2.5
Central government (percent of GDP on a fiscal year basis) [2]									
Revenue	32.1	26.5	38.3	39.1	36.9	32.4	33.0	32.6	33.0
Tax and nontax revenue	24.5	22.1	24.0	24.5	27.1	28.0	27.0	27.3	27.5
Grants	7.6	4.4	14.2	14.5	9.8	4.4	6.1	5.3	5.5
Expenditure and net lending	35.0	33.4	39.6	40.5	41.1	41.0	38.9	35.4	35.4
Overall balance (excluding grants)	-10.5	-11.3	-15.6	-15.9	-13.9	-13.1	-11.9	-8.1	-8.0
Overall balance (including grants)	-2.9	-6.9	-1.3	-1.4	-4.2	-8.6	-5.9	-2.8	-2.4
Foreign financing	1.3	1.6	2.6	2.7	4.9	2.8	4.0	1.8	2.0
Domestic financing	1.7	6.7	-0.2	-0.2	0.4	5.9	1.9	1.0	0.4
Discrepancy	-0.1	-1.5	-1.1	-1.1	-1.2	-0.1	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	35.7	22.9	25.6	35.1	23.5	15.1	21.5	14.9	13.2
Net foreign assets	-7.9	9.3	17.8	26.5	4.3	15.9	8.2	7.4	3.0
Net domestic assets	43.6	13.6	7.9	8.6	19.2	-0.9	13.3	7.5	10.2
Credit to the government	19.7	0.0	16.3	11.3	-7.5	-10.4	6.1	-0.9	-2.1
Credit to the private sector (percent change)	20.5	25.4	7.8	14.4	37.0	20.5	17.6	18.1	19.0
External sector (US$ millions, unless otherwise indicated)									
Exports (goods and services)	1,409	1,404	1,499	1,624	1,631	1,746	1,847	2,049	2,156
Imports (goods and services)	2,236	2,266	2,260	2,313	2,461	2,381	2,523	2,754	2,899
Gross official reserves	190	215	403	397	453	599	698	791	817
(months of imports)	1.0	1.2	2.0	2.0	2.0	2.9	3.0	3.3	3.4
(percent of reserve money)	42.6	63.1	120.8	108.3	117.8	131.5	119.7	122.3	110.9
Current account (percent of GDP)	-5.9	-3.5	-3.5	-1.8	-2.6	-5.1	-3.4	-2.7	-2.5
Current account, excl. official transfers (percent of GDP)	-12.2	-17.5	-16.4	-15.0	-16.8	-11.7	-11.1	-10.3	-9.9
Real effective exchange rate (percent change)[3]	-4.4 ..	-17.9	...	-14.9	...	11.5	...	...	...
Overall balance (percent of GDP)	-1.6	2.2	2.4	4.4	6.4	4.3	1.5	1.7	1.4
Terms of trade (percent change)	-16.1	-3.1	0.3	0.6	2.5	2.1	8.1	-3.5	-2.2
Debt stock and service (percent of GDP, unless otherwise indicated)									
External debt (public sector)	16.9 ..	37.7	41.5	44.0	38.9	47.3	35.3	34.1	31.9
NPV of external debt (percent of exports)	48.1	53.3	49.4	78.9	44.5	90.4	88.2	85.0	75.4
Domestic public debt	23.1	19.5	---	28.1	---	28.5	25.0	22.8	18.8
Total public debt	40.0	57.2	---	72.1	---	75.8	60.2	56.9	50.7
External debt service (percent of exports)	1.4	2.0	2.7	4.6	4.0	4.7	8.0	13.2	8.3
External debt service (percent of revenue excl. grants)	1.5	2.9	5.0	7.5	6.1	7.1	11.3	17.4	9.8
91-day treasury bill rate (end of period)	6.8 ..	20.0	...	32.3	...	26.9	...	...	...

Sources: Malawian authorities and IMF staff estimates.

[1] IMF Country Report No. 14/37.

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

[3] The figure for 2014 is the annual percent change of the REER at end-November 2014.

Table 2a. Malawi: Central Government Operations: 2011/12–2017/18
(Billions of Kwacha)

25-Feb-15	2011/12	2012/13	2013/14		2014/15		2015/16	2016/17	2017/18
	Actual	Actual	Prog.[1]	Actual	Budget	Proj.		Proj.	
Revenue	257	472	583	511	641	658	774	895	1,004
Tax and nontax revenue	214	297	428	441	531	537	648	745	848
Tax Revenue	188	269	375	388	476	481	579	662	754
Taxes on income and profits	90	129	168	181	226	237	289	329	371
Taxes on goods and services	84	111	162	168	207	202	237	272	313
Taxes on international trade	18	33	47	41	50	50	63	73	83
Other taxes	-3	-4	-3	-2	-8	-8	-10	-11	-13
Nontax revenue [2]	26	28	54	53	55	57	69	82	94
Grants	43	176	154	70	110	121	126	150	156
Budget support grants	0	78	31	7	0	8	7	0	0
Project grants	18	35	64	41	72	72	76	103	101
Dedicated grants	25	64	59	22	39	41	43	47	54
Expenditure and net lending	324	489	648	647	748	775	841	961	1,067
Current expenditure	246	385	504	547	550	582	650	716	799
Wages and salaries	70	97	137	140	163	163	193	216	246
Interest payments	24	33	93	98	80	105	108	103	93
Domestic	22	29	88	94	75	91	90	91	85
Foreign	2	4	5	4	6	14	19	12	8
Goods and services	95	144	156	176	161	158	184	215	245
Generic goods and services	53	60	36	65	70	66	77	90	107
Road Maintenance	7	7	9	8	10	11	11	15	18
Agricultural SWAp			16	9	2	2	2	3	3
Health SWAp	16	32	23	20	31	31	37	44	49
Education SWAp	9	22	19	19	23	23	29	33	37
National / local elections	0	1	18	11	1	1	1	1	2
PFEM			2	3	0	1	1	1	1
Statutory expenditures	4	6	5	7	4	3	3	4	4
National AIDS Commission	5	5	17	9	4	4	5	5	6
Maize purchases	1	3	3	14	5	5	6	7	8
Rural Electrification Program		8	8	10	11	11	11	11	11
Subsidies and other current transfers	57	98	111	125	135	145	165	182	214
Pension and gratuities	10	16	20	20	25	25	30	34	39
Transfers to road and revenue authorities	5	8	11	13	14	14	17	17	23
Transfers to public entities	17	22	30	32	46	46	42	46	52
Fertilizer and seed subsidy	24	52	50	60	50	60	75	86	101
Arrears payments	0	12	8	8	10	10	0	0	0
Development expenditure	78	104	144	100	196	191	191	245	268
Foreign financed	35	72	113	81	147	153	133	175	182
Domestically financed	42	32	31	20	49	38	58	70	86
Net lending	0	0	0	0	2	2	0	0	0
Overall balance (including grants)	-66	-16	-66	-136	-107	-117	-67	-66	-63
Discrepancy[3]	-15	-14	-18	-2	0	0	0	0	0
Overall balance (incl. grants and discrepancy)	-81	-30	-84	-138	-107	-117	-67	-66	-63
Total financing (net)	81	30	84	138	107	117	67	66	63
Foreign financing (net)	16	33	77	45	92	80	42	56	63
Borrowing	18	38	83	54	103	99	74	90	99
Budget support loans	1	0	35	14	37	0	18	18	19
Project loans	17	38	49	40	66	82	57	72	81
Other external loans[4]	0	0	0	0	0	18	0	0	0
Amortization	-3	-5	-6	-9	-11	-20	-32	-34	-36
Net domestic financing	65	-2	7	93	15	37	25	10	0
Memorandum items:									
Domestic fiscal balance[5]	-74	-120	-107	-126		-82	-61	-41	-36
New securitized arrears	---	---	---	39		157	--- --	---	---
Nominal GDP	969	1,208	1,578	1,578		1,991	2,377	2,712	3,069

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] IMF Country Report No. 14/37.

[2] Nontax revenues in 2013/14 and 2014/15 include the RBM profit transfer to government of MK19.2 billion and MK10 billion, respectively.

[3] Part of the discrepancy in 2012/13 is explained by the government's issuance of promissory note for the RBM recapitalization in the magnitude of MK28.5 billion, which was included in financing but did not have an associated cash expenditure.

[4] 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).

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

Table 2b. Malawi: Central Government Operations: 2011/12–2017/18
(Percent of GDP)

25-Feb-15	2011/12	2012/13	2013/14		2014/15		2015/16	2016/17	2017/18
	Actual	Actual	Prog.[1]	Actual	Budget	Proj.		Proj.	
Revenue	26.5	39.1	36.9	32.4	32.2	33.0	32.6	33.0	32.7
Tax and nontax revenue	22.1	24.5	27.1	28.0	26.7	27.0	27.3	27.5	27.6
Tax Revenue	19.4	22.3	23.7	24.6	23.9	24.1	24.4	24.4	24.6
Taxes on income and profits	9.2	10.7	10.7	11.4	11.3	11.9	12.2	12.1	12.1
Taxes on goods and services	8.7	9.2	10.3	10.7	10.4	10.2	10.0	10.0	10.2
Taxes on international trade	1.9	2.7	3.0	2.6	2.5	2.5	2.7	2.7	2.7
Other taxes	-0.3	-0.3	-0.2	-0.1	-0.4	-0.4	-0.4	-0.4	-0.4
Nontax revenue [2]	2.7	2.3	3.4	3.3	2.8	2.8	2.9	3.0	3.1
Grants	4.4	14.5	9.8	4.4	5.5	6.1	5.3	5.5	5.1
Budget support grants	0.0	6.4	2.0	0.4	0.0	0.4	0.3	0.0	0.0
Project grants	1.9	2.9	4.1	2.6	3.6	3.6	3.2	3.8	3.3
Dedicated grants	2.5	5.3	3.8	1.4	1.9	2.1	1.8	1.7	1.8
Expenditure and net lending	33.4	40.5	41.1	41.0	37.6	38.9	35.4	35.4	34.7
Current expenditure	25.4	31.9	32.0	34.7	27.6	29.2	27.3	26.4	26.0
Wages and salaries	7.2	8.0	8.7	8.9	8.2	8.2	8.1	8.0	8.0
Interest payments	2.5	2.8	5.9	6.2	4.0	5.3	4.6	3.8	3.0
Domestic	2.2	2.4	5.6	6.0	3.8	4.6	3.8	3.3	2.8
Foreign	0.2	0.3	0.3	0.2	0.3	0.7	0.8	0.5	0.3
Goods and services	9.8	11.9	9.9	11.2	8.1	7.9	7.7	7.9	8.0
Generic goods and services	5.5	5.0	2.3	4.1	3.5	3.3	3.3	3.3	3.5
Road Maintenance	0.7	0.6	0.6	0.5	0.5	0.6	0.5	0.6	0.6
Agricultural swap	0.0	0.0	1.0	0.6	0.1	0.1	0.1	0.1	0.1
Health SWAp	1.7	2.6	1.4	1.3	1.6	1.6	1.5	1.6	1.6
Education SWAp	0.9	1.8	1.2	1.2	1.2	1.2	1.2	1.2	1.2
National / local elections	0.0	0.1	1.1	0.7	0.0	0.1	0.1	0.1	0.1
PFEM	0.0	0.0	0.1	0.2	0.0	0.0	0.0	0.0	0.0
Statutory expenditures	0.4	0.5	0.3	0.5	0.2	0.1	0.1	0.1	0.1
National AIDS Commission	0.5	0.4	1.1	0.6	0.2	0.2	0.2	0.2	0.2
Maize purchases	0.1	0.3	0.2	0.9	0.3	0.3	0.3	0.3	0.3
Rural Electrification Program	0.0	0.7	0.5	0.6	0.6	0.6	0.5	0.4	0.4
Subsidies and other current transfers	5.9	8.1	7.1	7.9	6.8	7.3	6.9	6.7	7.0
Pension and gratuities	1.1	1.3	1.2	1.2	1.2	1.3	1.3	1.3	1.3
Transfers to road and revenue authorities	0.6	0.7	0.7	0.8	0.7	0.7	0.7	0.6	0.7
Transfers to public entities	1.8	1.9	1.9	2.0	2.3	2.3	1.8	1.7	1.7
Fertilizer and seed subsidy	2.5	4.3	3.2	3.8	2.5	3.0	3.2	3.2	3.3
Arrears payments	0.0	1.0	0.5	0.5	0.5	0.5	0.0	0.0	0.0
Development expenditure	8.0	8.6	9.1	6.4	9.8	9.6	8.0	9.0	8.7
Foreign financed	3.6	6.0	7.2	5.1	7.4	7.7	5.6	6.5	5.9
Domestically financed	4.4	2.6	2.0	1.2	2.5	1.9	2.5	2.6	2.8
Net lending	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0
Overall balance (including grants)	-6.9	-1.3	-4.2	-8.6	-5.4	-5.9	-2.8	-2.4	-2.0
Discrepancy [3]	-1.5	-1.1	-1.2	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-8.4	-2.5	-5.3	-8.7	-5.4	-5.9	-2.8	-2.4	-2.0
Total financing (net)	8.3	2.5	5.3	8.7	5.4	5.9	2.8	2.4	2.0
Foreign financing (net)	1.6	2.7	4.9	2.8	4.6	4.0	1.8	2.0	2.1
Borrowing	1.9	3.1	5.3	3.4	5.2	5.0	3.1	3.3	3.2
Budget support loans	0.1	0.0	2.2	0.9	1.9	0.0	0.7	0.7	0.6
Project loans	1.8	3.1	3.1	2.5	3.3	4.1	2.4	2.6	2.6
Other external loans[4]	0.0	0.0	0.0	0.0	0.0	0.9	0.0	0.0	0.0
Amortization	-0.3	-0.4	-0.4	-0.6	-0.6	-1.0	-1.4	-1.3	-1.2
Net domestic financing	6.7	-0.2	0.4	5.9	0.8	1.9	1.0	0.4	0.0
Memorandum items:									
Domestic fiscal balance [5]	-7.6	-9.9	-6.8	-8.0		-4.1	-2.5	-1.5	-1.2
New securitized arrears	---	---	---	2.5		7.9	---	---	---
Nominal GDP	969	1,208	1,578	1,578		1,991	2,377	2,712	3,069

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] IMF country report No. 14/37.

[2] Nontax revenues in 2013/14 and 2014/15 include the RBM profit transfer to government of MK19.2 billion and MK10 billion, respectively.

[3] Part of the discrepancy in 2012/13 is explained by the government's issuance of promissory note for RBM recapitalization in the magnitude of MK28.5 billion, which was included in financing, but did not have an associated cash expenditure.

[4] 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).

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

Table 2c. Malawi: Central Government Operations: 2014/15 and 2015/16

(Billions of Kwacha)

	2014/15					2015/16				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	124.5	178.0	165.7	189.6	657.8	162.2	194.8	190.6	226.7	774.3
Tax and nontax revenue	117.0	129.1	133.6	157.5	537.2	141.2	154.5	160.9	191.2	647.9
Tax revenue	108.1	116.0	123.1	133.3	480.5	131.1	139.4	149.0	159.8	579.3
Taxes on income and profits	52.4	53.1	62.4	69.0	236.8	63.6	64.7	76.3	84.2	288.9
Taxes on goods and services	45.9	51.9	50.5	53.8	202.2	53.9	60.7	59.6	63.1	237.3
Taxes on international trade	11.7	13.0	12.4	12.8	49.9	14.7	16.5	15.7	16.2	63.0
Other taxes	-1.8	-2.1	-2.2	-2.3	-8.4	-1.2	-2.5	-2.6	-3.8	-10.0
Nontax revenue [1]	8.8	13.2	10.4	24.2	56.7	10.1	15.1	12.0	31.4	68.6
Grants	7.5	48.9	32.1	32.0	120.6	21.0	40.3	29.6	35.5	126.5
Budget support grants	0.0	0.0	0.0	8.0	8.0	0.0	0.0	0.0	7.0	7.0
Project grants	5.6	18.0	17.6	30.4	71.6	18.7	19.0	19.2	19.1	76.1
Dedicated grants	1.9	30.9	6.5	1.6	41.0	2.3	21.3	10.4	9.4	43.4
Expenditure and net lending	171.7	203.2	204.6	195.0	774.5	205.7	210.0	213.5	212.0	841.2
Current expenditure	147.8	164.3	151.6	117.8	581.6	160.9	172.7	170.1	146.3	650.0
Wages and salaries	41.4	40.3	40.8	40.8	163.3	48.9	47.5	48.2	48.2	192.7
Interest payments	38.7	22.2	26.3	18.0	105.1	35.5	22.0	27.7	23.3	108.5
Domestic	38.1	19.9	20.6	12.5	91.0	30.2	16.6	23.6	19.3	89.7
Foreign	0.6	2.3	5.7	5.5	14.1	5.3	5.4	4.1	4.0	18.7
Goods and services	37.4	43.6	36.8	40.4	158.2	40.7	51.4	43.2	48.7	183.9
Generic goods and services	16.3	22.9	14.6	12.2	66.0	16.2	26.9	17.1	17.3	77.5
Census	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Road Maintenance	2.3	3.5	2.7	3.0	11.4	2.3	3.5	2.7	3.0	11.5
Agricultural swap	0.0	1.0	1.0	0.0	2.0	0.6	0.6	0.6	0.6	2.4
Health SWAp	5.7	4.3	8.0	13.0	31.0	6.8	5.1	9.5	15.4	36.8
Education SWAp	5.2	5.0	5.0	8.2	23.5	6.6	7.2	7.5	7.5	28.9
National / local elections	0.7	0.1	0.1	0.2	1.0	0.3	0.3	0.3	0.3	1.2
PFEM	0.4	0.1	0.1	0.1	0.6	0.2	0.2	0.2	0.2	0.6
Statutory expenditures	1.2	1.0	0.3	0.2	2.7	1.4	1.2	0.4	0.2	3.2
National AIDS Commission	1.7	1.0	1.3	0.0	4.0	1.6	1.2	1.0	1.0	4.7
Maize purchases	1.7	2.0	1.0	0.3	5.0	2.0	2.4	1.2	0.4	6.0
Rural Electrification Program	2.3	2.8	2.8	3.2	11.1	2.8	2.8	2.8	2.8	11.1
Subsidies and other current transfers	23.4	55.2	47.7	18.6	144.9	35.9	51.9	51.1	26.1	164.9
Pension and gratuities	5.3	7.8	7.0	4.9	25.0	6.4	9.3	8.4	5.8	29.8
Transfers to road and revenue authorities	4.0	4.0	3.0	3.0	14.0	3.9	4.2	4.5	4.8	17.4
Transfers to public entities and households	8.9	12.7	14.0	10.7	46.3	9.1	10.6	11.3	11.3	42.2
Of which, roofing sheets and cement program	0.0	1.5	4.0	1.5	7.0	0.0	0.0	0.0	0.0	0.0
Fertilizer and seed subsidy	5.2	30.7	23.7	0.0	59.7	16.5	27.9	27.0	4.1	75.4
Arrears payments	6.9	3.1	0.0	0.0	10.0	0.0	0.0	0.0	0.0	0.0
Development expenditure	23.9	37.9	52.5	76.7	191.0	44.8	37.3	43.4	65.7	191.2
Foreign financed	19.4	26.0	42.6	65.4	153.3	29.6	21.2	29.8	52.2	132.8
Domestically financed	4.5	11.9	9.9	11.3	37.6	15.2	16.1	13.6	13.6	58.4
Net lending	0.0	1.0	0.5	0.5	2.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	-47.2	-25.2	-39.0	-5.4	-116.7	-43.5	-15.2	-22.9	14.7	-66.9
Discrepancy	13.9	0.0	0.0	-13.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-33.3	-25.2	-39.0	-19.3	-116.7	-43.5	-15.2	-22.9	14.7	-66.9
Total financing (net)	33.3	25.2	39.0	19.3	116.7	43.5	15.2	22.9	-14.7	66.9
Foreign financing (net)	13.8	1.5	23.1	41.4	79.7	3.0	-2.5	8.5	33.3	42.3
Borrowing	13.8	9.2	28.3	48.1	99.4	10.9	5.4	16.7	41.4	74.4
Budget support	0.0	0.0	0.0	0.0	0.0	0.0	3.2	6.1	8.3	17.7
Project	13.8	8.0	25.0	35.0	81.8	10.9	2.2	10.6	33.1	56.8
Other external loans	0.0	1.2	3.3	13.1	17.6	0.0	0.0	0.0	0.0	0.0
Amortization	0.0	-7.7	-5.2	-6.7	-19.6	-7.8	-8.0	-8.2	-8.1	-32.1
Net domestic financing	19.5	23.7	15.9	-22.1	37.0	40.4	17.8	14.4	-48.0	24.6
Memorandum item:										
Domestic fiscal balance [2]	-35.4	-47.1	-28.0	28.5	-82.0	-34.8	-34.3	-22.7	31.4	-60.5

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] Nontax revenue in 2014/15 includes the RBM profit transfer of MK10 billion to government.

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

Table 3a. Malawi: Monetary Authorities' Survey, 2012–17

(Billions of Kwacha, unless otherwise indicated)

25-Feb-15	2012	2013		2014						2015			2016	2017
	Dec.	Dec.		Mar.		Jun.		Sept.	Dec.	Mar.	Jun.	Dec.	Dec.	Dec.
	Act.	Prog.[1]	Act.	Prog.[1]	Act.	Prog.[1]	Act.	Act.	Est.		Proj.		Proj.	Proj.
Reserve money	113	135	157	134	169	145	193	192	215	223	244	261	295	334
Currency outside banks	55	...	76	...	68	...	100	93	...	...	...	...	...	...
Cash in vault	16	...	19	...	13	...	14	17	...	...	...	...	...	...
Commercial bank deposits with RBM	42	...	62	...	88	...	79	82	...	...	...	...	...	...
Net foreign assets (NFA)	-20	35	42	27	66	61	63	71	148	176	173	197	242	260
Foreign assets	80	165	174	154	193	188	186	189	282	303	297	312	361	388
Foreign liabilities	-100	-126	-133	-105	-127	-112	-123	-118	-134	-127	-124	-115	-119	-128
Net domestic assets	133	100	115	107	103	84	130	121	66	48	71	64	53	74
Credit to government (net)	110	119	126	105	108	75	152	161	67	74	63	92	93	86
Credit to domestic banks	-14	0	0	0	0	0	0	0	0	0	0	0	0	0
Other items (net)	37	-20	-11	2	-5	9	-22	-40	0	-27	8	-28	-40	-12
Open market operations	-14	-25	-5	-3	-5	2	0	0	...	...	...	...	...	...
Others	51	5	-6	5	0	7	-22	-40	...	...	...	...	...	...
Memorandum items:														
Money multiplier	3.4	3.7	3.3	3.8	3.1	3.8	2.9	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Annual growth of reserve money (percent)	54.6	36.1	38.6	49.9	69.2	14.7	52.6	42.6	36.8	32.1	26.2	21.4	13.3	13.2
91-day treasury bill rate	20.0	...	32.3	...	13.0	...	21.1	19.2	0.0	...	...	...	...	...
NFA (US$ millions)	-50	86	99	67	161	158	158	173	315	378	390	440	531	573
Foreign assets (US$ millions)	247	406	404	380	470	484	467	458	599	650	670	698	791	856
Foreign liabilities (US$ millions)	-297	-302	-305	-313	-309	-326	-309	-286	-284	-272	-280	-258	-260	-283

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

[1] IMF Country Report No. 14/37.

Table 3b. Malawi: Monetary Survey, 2012–17

(Billions of Kwacha, unless otherwise indicated)

25-Feb-15	2012	2013		2014						2015			2016	2017
	Dec.	Dec.		Mar.		Jun.		Sept.	Dec.	Mar.	Jun.	Dec.	Dec.	Dec.
	Act.	Prog.[1]	Act.	Prog.[1]	Act.	Prog.[1]	Act.	Act.	Est.		Proj.		Proj.	Proj.
Money and quasi-money	386	486	522	511	518	552	559	544	601	626	671	730	838	949
Money	222	...	201	...	242	...	244	240	...	...	...	...	...	...
Quasi-money	164	...	321	...	276	...	315	304	...	...	...	...	...	...
Of which: foreign currency deposits	72	...	139	...	93	...	128	116	...	...	...	...	...	...
Net foreign assets (NFA)	32	100	134	93	103	125	111	114	217	230	256	267	321	346
Monetary authorities	-20	35	42	27	66	61	63	71	148	176	173	197	242	260
Gross foreign assets	80	165	174	154	193	188	186	189	282	303	297	312	361	388
Foreign liabilities	-100	-126	-133	-112	-127	-119	-123	-118	-134	-127	-124	-115	-119	-128
Commercial banks (net)	51	65	92	66	37	64	48	43	69	54	83	70	78	86
Net domestic assets	355	385	388	417	415	427	449	430	383	395	415	463	518	603
Credit to government (net)	141	204	184	186	180	140	242	236	130	141	126	166	160	142
Credit to statutory bodies (net)	19	18	18	18	4	18	5	3	5	5	5	6	6	8
Credit to private sector	219	238	250	288	265	332	270	271	302	313	324	355	419	499
Other items (net)	-24	-75	-65	-75	-33	-65	-69	-80	-53	-64	-40	-64	-67	-46
Memorandum items:														
Velocity of money (annualized GDP divided by broad money)	2.7	2.9	2.7	2.9	2.9	2.9	2.8	3.1	3.0	3.0	3.0	3.0	3.0	3.0
Annual growth of broad money (percent)	22.9	25.6	35.1	28.5	30.5	23.1	24.8	12.7	15.1	20.6	19.9	21.5	14.9	13.2
Annual growth of credit to the private sector (percent)	25.4	8.9	14.4	25.8	15.7	43.4	16.6	17.7	20.5	18.3	19.8	17.6	18.1	19.0
NFA of the commercial banks (US$ millions)	153.3	160.9	212.3	163.3	90.3	165.8	120.1	103.3	146.6	116.6	186.6	156.6	171.6	189.6
Gross foreign assets (US$ millions)	199.5	209.5	242.1	212.6	131.1	215.8	166.7	135.7	169.0	139.0	209.0	179.0	194.0	212.0
Foreign liabilities (US$ millions)	-46.3	-48.6	-29.8	-49.3	-40.8	-50.1	-46.5	-32.4	-22.4	-22.4	-22.4	-22.4	-22.4	-22.4
Foreign currency deposits(US$ millions)	218.2	...	325.5	...	226.1	...	272.7	260.7	...	...	...	...	...	
Nominal GDP (billions of Kwacha)	1057		1415						1,809			2,224	2,556	2,893

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

[1] IMF Country Report No. 14/37.

Table 4a. Malawi: Balance of Payments, 2011–17

(US$ millions, unless otherwise indicated)

	2011	2012	2013		2014		2015	2016	2017
	Act.	Act.	Prog.[3]	Est.	Prog.[3]	Proj.		Proj.	
Current account balance (including grants)	-330.0	-146.5	-136.1	-67.8	-177.7	-215.6	-167.8	-152.4	-161.3
Merchandise trade balance	-630.1	-662.3	-523.5	-475.0	-579.4	-444.5	-465.7	-428.6	-428.6
Exports	1,262.7	1,255.3	1,385.3	1,467.8	1,505.2	1,570.4	1,662.0	1,869.7	2,026.3
Of which: Tobacco	482.4	480.9	358.2	432.8	394.9	480.7	479.9	495.1	518.4
Uranium	120.4	154.4	169.9	169.9	161.6	40.4	0.0	0.0	0.0
Imports	-1,892.7	-1,917.6	-1,908.8	-1,942.8	-2,084.7	-2,014.9	-2,127.6	-2,298.3	-2,455.0
Of which : Petroleum	-168.8	-173.7	-177.1	-176.6	-177.0	-183.0	-116.1	-149.0	-168.4
Services balance	-312.8	-334.5	-382.0	-373.0	-394.3	-361.4	-408.8	-472.2	-529.9
Interest public sector (net)	-5.6	-10.0	-9.1	-9.1	-10.0	-19.3	-48.4	-36.9	-37.7
Other factor payments (net)	-109.7	-124.8	-135.2	-150.3	-134.1	-151.9	-150.5	-159.3	-178.1
Nonfactor (net)	-197.5	-243.9	-237.6	-213.6	-250.3	-190.2	-209.9	-276.1	-314.1
Unrequited transfers (net)	612.9	850.3	769.4	780.2	857.6	590.3	706.6	748.5	797.2
Private (net)	256.0	259.8	273.8	274.4	295.5	309.0	323.8	310.5	328.0
Official (net)	356.9	590.5	495.6	505.8	562.2	281.2	382.8	438.0	469.2
Receipts	357.7	591.3	496.4	506.6	563.0	282.0	383.6	438.8	470.1
Budget support	0.0	181.4	73.5	73.0	111.2	0.0	17.7	15.9	0.0
Project related[1]	357.6	409.8	422.9	433.6	451.8	282.0	365.9	423.0	470.1
Payments	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Financial account balance	157.4	243.3	227.6	238.7	396.5	397.8	240.3	247.1	249.8
Medium- and long-term flows (net)	108.9	76.0	126.4	86.0	271.7	126.6	131.9	131.7	121.4
Disbursements	123.3	93.4	137.1	96.7	297.5	188.5	204.0	205.0	200.0
Budget support and other program loans	0.0	0.0	33.1	22.4	113.3	42.6	43.3	40.0	40.5
Project support	53.3	76.0	96.5	63.3	134.2	130.9	160.7	165.1	159.4
Other medium-term loans	70.0	17.4	7.4	11.1	50.0	15.0	0.0	0.0	0.0
Amortization	-14.4	-17.4	-10.7	-10.7	-25.7	-61.8	-72.0	-73.3	-78.6
Foreign direct investment and other inflows	60.8	81.9	92.9	92.9	114.2	336.0	97.5	99.5	109.4
Short-term capital	0.7	0.7	0.7	0.8	0.8	0.8	0.9	0.9	1.0
Commercial banks net foreign assets	-13.0	84.7	7.6	59.1	9.8	-65.7	10.0	15.0	18.0
Errors and omissions	-84.3	3.6	0.0	2.3	0	0	0	0	0
Overall balance	-88.3	93.3	91.5	168.6	37.2	182.1	72.5	94.7	88.5
Financing	88.3	-93.3	-89.5	-168.6	-89.2	-182.1	-72.5	-94.7	-88.5
Gross reserves (- increase)	89.4	-45.6	-136.3	-161.2	-101.4	-202.4	-98.6	-92.8	-65.4
Liabilities	-1.1	-47.6	46.8	-7.4	12.2	20.3	26.1	-1.9	-23.1
Of which: IMF (net)	-0.1	37.0	81.6	12.3	13.5	-13.5	26.1	-1.9	-23.1
Purchases/drawings	0.0	40.2	90.2	20.1	40.2	17.6	51.6	25.0	0.0
Repurchases/repayments	0.1	3.2	8.6	7.8	26.6	31.1	25.5	27.0	23.1
Memorandum items:									
Gross official reserves	190.2	215.4	351.7	397.0	453.1	599.4	697.9	790.7	817.4
Months of imports[2]	1.0	1.2	2.0	2.0	2.0	2.9	3.0	3.3	3.4
Current account balance (percent of GDP)									
Excluding official transfers	-12.2	-17.5	-16.4	-15.0	-16.8	-11.7	-11.1	-10.3	-9.9
Including official transfers	-5.9	-3.5	-3.5	-1.8	-4.0	-5.1	-3.4	-2.7	-2.5
Import price index (2005 = 100)	143.4	141.8	134.8	140.2	134.5	136.2	119.8	123.2	125.2
Import volume (percent change)	-13.7	-11.0	-3.9	2.5	-1.9	4.9	8.7	5.9	6.1
REER (percent change)	-4.4	-17.9	...	-14.9	...	...	...	...	...
Overall balance (percent of GDP)	-1.6	2.2	2.4	4.4	6.4	4.3	1.5	1.7	1.4
Terms of trade (percent change)	-16.1	-3.1	0.3	0.6	2.5	2.1	8.1	-3.5	-2.2
Nominal GDP (millions of U.S. dollars)	5,617.0	4,208.9	3,847.8	3,822.5	4,404.0	4,263.3	4,943.4	5,708.8	6,382.4

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

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

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

[3] IMF Country Report No. 14/37.

Table 4b. Malawi: Balance of Payments, 2011–17

(Percent of GDP)

	2011	2012	2013		2014		2015	2016	2017
	Act.	Act.	Prog.[2]	Est.	Prog.[2]	Proj.		Proj.	
Current account balance (including grants)	-5.9	-3.5	-3.5	-1.8	-4.0	-5.1	-3.4	-2.7	-2.5
Merchandise trade balance	-11.2	-15.7	-13.6	-12.4	-13.2	-10.4	-9.4	-7.5	-6.7
Exports	22.5	29.8	36.0	38.4	34.2	36.8	33.6	32.8	31.7
Of which: Tobacco	8.6	11.4	9.3	11.3	9.0	11.3	9.7	8.7	8.1
Uranium	2.1	3.7	4.4	4.4	3.7	0.9	0.0	0.0	0.0
Imports	-33.7	-45.6	-49.6	-50.8	-47.3	-47.3	-43.0	-40.3	-38.5
Of which : Petroleum	-3.0	-4.1	-4.6	-4.6	-4.0	-4.3	-2.3	-2.6	-2.6
Services balance	-5.6	-7.9	-9.9	-9.8	-9.0	-8.5	-8.3	-8.3	-8.3
Interest public sector (net)	-0.1	-0.2	-0.2	-0.2	-0.2	-0.5	-1.0	-0.6	-0.6
Other factor payments (net)	-2.0	-3.0	-3.5	-3.9	-3.0	-3.6	-3.0	-2.8	-2.8
Nonfactor (net)	-3.5	-5.8	-6.2	-5.6	-5.7	-4.5	-4.2	-4.8	-4.9
Transfers (net)	10.9	20.2	20.0	20.4	19.5	13.8	14.3	13.1	12.5
Private (net)	4.6	6.2	7.1	7.2	6.7	7.2	6.6	5.4	5.1
Official (net)	6.4	14.0	12.9	13.2	12.8	6.6	7.7	7.7	7.4
Receipts	6.4	14.0	12.9	13.3	12.8	6.6	7.8	7.7	7.4
Budget support	0.0	4.3	1.9	1.9	2.5	0.0	0.4	0.3	0.0
Project related[1]	6.4	9.7	11.0	11.3	10.3	6.6	7.4	7.4	7.4
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	2.8	5.8	5.9	6.2	9.0	9.3	4.9	4.3	3.9
Medium- and long-term flows (net)	1.9	1.8	3.3	2.2	6.2	3.0	2.7	2.3	1.9
Loan disbursements	2.2	2.2	3.6	2.5	6.8	4.4	4.1	3.6	3.1
Budget support and other program loans	0.0	0.0	0.9	0.6	2.6	1.0	0.9	0.7	0.6
Project support loans	0.9	1.8	2.5	1.7	3.0	3.1	3.3	2.9	2.5
Other medium-term loans	1.2	0.4	0.2	0.3	1.1	0.4	0.0	0.0	0.0
Amortization	-0.3	-0.4	-0.3	-0.3	-0.6	-1.5	-1.5	-1.3	-1.2
Foreign direct investment and other inflows	1.1	1.9	2.4	2.4	2.6	7.9	2.0	1.7	1.7
Commercial banks net foreign assets	-0.2	2.0	0.2	1.5	0.2	-1.5	0.2	0.3	0.3
Errors and omissions	-1.5	0.1	1.3	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.6	2.2	2.4	4.4	0.8	4.3	1.5	1.7	1.4
Financing	1.6	-2.2	-2.4	-4.4	-6.4	-4.3	-1.5	-1.7	-1.4
Gross reserves (- increase)	1.6	-1.1	-3.5	-4.2	-6.6	-4.7	-2.0	-1.6	-1.0
Liabilities	0.0	-1.1	1.2	-0.2	0.3	0.5	0.5	0.0	-0.4
Of which: IMF (net)	0.0	0.9	2.1	0.3	0.3	-0.3	0.5	0.0	-0.4
Purchases/drawings	0.0	1.0	2.3	0.5	0.9	0.4	1.0	0.4	0.0
Repurchases/repayments	0.0	0.1	0.2	0.2	0.6	0.7	0.5	0.5	0.4
Memorandum items:									
Gross official reserves	3.4	5.1	10.5	10.4	10.3	14.1	14.1	13.9	12.8
Current account balance (percent of GDP)									
Excluding official transfers	-12.2	-17.5	-16.4	-15.0	-16.8	-11.7	-11.1	-10.3	-9.9
Including official transfers	-5.9	-3.5	-3.5	-1.8	-4.0	-5.1	-3.4	-2.7	-2.5
Value of exports of goods and services (percent change)	3.6	-0.3	10.3	15.7	8.8	7.5	5.8	11.0	5.2
Value of imports of goods and services (percent change)	-7.8	1.3	0.1	2.1	8.9	2.9	6.0	9.2	5.3

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

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

[2] IMF Country Report No. 14/37.

Table 5. Malawi: Selected Banking Soundness Indicators, 2010–14

(Percent)

Key ratios	Dec-10	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Capital Adequacy													
1. Regulatory Tier 1 capital to risk weighted assets	15.6	16.5	18.7	16.2	16.6	16.4	17.6	16.1	16.2	16.2	14.7	14.9	14.5
2. Regulatory total capital to risk weighted assets	20.3	20.1	22.1	19.2	19.5	20.2	21.1	19.4	19.0	19.1	18.3	18.3	17.8
3. Total capital to total assets	15.8	14.6	15.3	13.9	14.7	14.3	15.5	15.1	15.2	15.4	17.1	17.9	18.7
Asset composition and quality													
1. Non-performing loans to gross loans	3.9	4.1	5.0	5.5	6.5	9.4	11.6	12.6	13.6	15.4	15.7	16.8	15.8
2. Provisions to non-performing loans	31.5	36.9	20.9	30.5	34.5	26.8	27.1	30.5	27.6	29.1	30.3	28.3	30.7
3. Total loans and advances to total assets	52.9	52.7	52.1	53.3	54.6	50.8	46.6	45.4	41.1	40.5	41.7	42.1	41.3
4. Foreign currency loans to total loans	n.a.	6.1	6.0	9.4	8.2	7.9	11.1	10.5	12.8	13.5	15.2	18.1	17.1
Earnings and profitability													
1. Return on assets (ROA)	4.2	3.5	5.4	5.1	4.9	5.0	5.3	4.7	5.0	4.8	4.5	4.9	4.6
2. Return on equity (ROE)	29.4	24.7	38.0	36.7	35.1	36.9	40.5	36.2	38.7	37.5	31.9	33.5	30.8
3. Non-interest expenses to gross income	50.2	46.0	45.4	44.3	44.3	36.8	37.6	37.8	38.0	39.7	43.9	43.2	42.1
4. Interest margin to gross income	49.2	46.0	39.2	37.9	36.6	36.8	36.7	38.9	38.7	39.7	46.4	43.1	44.0
5. Personnel expenses to non-interest expenses	n.a.	39.70	48.82	46.51	46.23	46.00	45.09	46.79	46.46	45.40	46.9	45.7	47.4
Liquidity													
1. Liquid assets to deposits and short-term liabilities	40.7	43.0	42.8	42.5	40.7	45.4	48.9	48.6	58.1	59.1	57.1	57.6	59.2
2. Total loans to total deposits	73.2	70.9	70.3	75.9	76.4	72.4	67.0	64.8	57.9	56.6	60.1	62.0	61.0
3. Liquid Assets to total assets	31.3	33.4	33.0	32.6	30.9	34.5	36.2	35.6	42.4	43.7	41.2	41.4	41.5
4. Foreign exchange liabilities to total liabilities	n.a.	7.8	n.a.	n.a.	n.a.	17.9	n.a.	n.a.	n.a.	26.3	n.a.	n.a.	n.a.

Source: Reserve Bank of Malawi

Table 6. Malawi: External Financing Requirement and Source, 2011–17
(In millions of US dollars)

25-Feb-15	2011	2012	2013	2014	2015	2016	2017
Total requirement	-612	-800	-746	-761	-721	-756	-775
Current account, excluding official transfer	-687	-737	-574	-497	-551	-590	-631
Debt amortization	-14	-17	-11	-62	-72	-73	-79
Gross reserves accumulation (- increase)	89	-46	-161	-202	-99	-93	-65
Total sources	612	800	746	761	721	757	775
Expected disbursements (official)	480	684	602	470	587	643	669
Grants	357	590	506	281	383	438	469
Medium- and long-term loans	123	93	97	188	204	205	200
Private sector (net)	132	79	131	305	108	115	128
IMF (net)	0	37	12	-14	26	-2	-23
Drawings	0	40	20	18	52	25	0
Repayments	0	3	8	31	26	27	23
Gross official reserves	190	215	397	599	698	791	817
Months of imports	1.0	1.2	2.0	2.9	3.0	3.3	3.4

Source: IMF staff estimates.

Table 7a. Malawi: Previous Schedule of Disbursements under ECF Arrangement, 2012–15

(Millions of SDR)

Amount	% of Quota	Date available	Conditions Necessary for Disbursement	Status
13.02	18.76	July 23, 2012	Executive Board Approval of Three Year ECF arrangement.	Disbursed
13.02	18.76	December 15, 2012	Observance of performance criteria for September 30, 2012 and completion of first review.	Disbursed
13.01	18.75	March 15, 2013	Observance of performance criteria for December 31, 2012 and completion of second review.	Disbursed
6.51	9.38	June 15, 2013	Observance of performance criteria for March 31, 2013 and completion of third review.	Disbursed
6.50	9.37	December 15, 2013	Observance of performance criteria for September 30, 2013 and completion of fourth review.	Disbursed
13.01	18.75	March 15, 2014	Observance of performance criteria for December 31, 2013 and completion of fifth review.	
13.01	18.75	September 15, 2014	Observance of performance criteria for June 30, 2014 and completion of sixth review.	
13.01	18.75	March 15, 2015	Observance of performance criteria for December 31, 2014 and completion of seventh review.	
13.01	18.75	September 15, 2015	Observance of performance criteria for June 30, 2015 and completion of eighth review.	
104.10	150.00	Total for the ECF arrangement		

Source: IMF staff estimates.

Table 7b. Malawi: Proposed new Schedule of Disbursements under ECF Arrangement, 2012–16

(Millions of SDR)

Amount	% of Quota	Date available	Conditions Necessary for Disbursement	Status
13.02	18.76	July 23, 2012	Executive Board Approval of Three Year ECF arrangement.	Disbursed
13.02	18.76	December 15, 2012	Observance of performance criteria for September 30, 2012 and completion of first review.	Disbursed
13.01	18.75	March 15, 2013	Observance of performance criteria for December 31, 2012 and completion of second review.	Disbursed
6.51	9.38	June 15, 2013	Observance of performance criteria for March 31, 2013 and completion of third review.	Disbursed
6.50	9.37	December 15, 2013	Observance of performance criteria for September 30, 2013 and completion of fourth review.	Disbursed
6.51	9.38	March 15, 2014	Observance of performance criteria for December 31, 2013 and completion of fifth review.	
6.51	9.38	September 15, 2014	Observance of performance criteria for June 30, 2014 and completion of sixth review.	
17.00	24.50	September 15, 2015	Observance of performance criteria for June 30, 2015 and completion of the seventh review.	
22.02	31.73	March 15, 2016	Observance of performance criteria for December 31, 2015 and completion of the eighth review.	
104.10	150.00	Total for the ECF arrangement		

Source: IMF staff estimates.

Table 8. Malawi: Indicators of Capacity to Repay the Fund, 2015–26

4-Mar-15	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Projected Payments based on Existing Drawings:												
(SDR millions)												
Principal	17.35	17.86	15.71	20.41	11.89	12.49	10.41	10.41	3.90	1.30	0.00	0.00
Charges and interest	0.00	0.00	0.00	0.00	0.11	0.08	0.05	0.03	0.01	0.00	0.00	0.00
Projected Payments based on Prospective Drawings:												
(SDR millions)												
Principal	0.00	0.00	0.00	0.00	0.00	1.30	8.21	10.41	10.41	10.41	9.11	2.20
Charges and interest	0.00	0.00	0.00	0.00	0.13	0.13	0.12	0.09	0.07	0.04	0.01	0.00
Projected Payments based on Existing and Prospective Drawings:												
SDR millions	17.4	17.9	15.7	20.4	12.1	14.0	18.8	20.9	10.5	10.5	9.1	2.2
US$ Millions	25.0	25.8	22.9	29.9	17.9	20.9	28.0	31.2	15.6	15.6	13.6	3.3
Percent of exports of goods and services	1.4	1.3	1.1	1.2	0.7	0.7	0.9	0.9	0.4	0.4	0.3	0.1
Percent of debt service	20.7	23.6	23.5	30.6	21.7	21.1	24.3	26.1	12.2	11.5	9.3	2.2
Percent of quota	25.0	25.7	22.6	29.4	17.5	20.2	27.1	30.2	15.1	15.1	13.1	3.2
Percent of gross official reserves	3.6	3.3	2.8	3.5	2.1	2.4	3.2	3.4	1.7	1.6	1.4	0.3
Projected Level of Credit Outstanding based on Existing and Prospective Drawings:												
SDR millions	147.6	161.5	145.8	125.4	113.5	99.1	76.9	51.5	32.6	16.3	3.2	0.0
US$ Millions	213.0	234.3	213.0	184.4	168.3	148.6	115.3	77.2	48.9	24.4	4.8	0.0
Percent of exports of goods and services	11.5	11.4	9.9	7.7	6.4	5.1	3.7	2.3	1.3	0.6	0.1	0.0
Percent of debt service	176.8	213.7	218.5	188.7	204.2	150.1	100.1	64.4	38.1	18.0	3.3	0.0
Percent of quota	212.7	232.7	210.1	180.7	163.6	142.9	110.8	74.2	47.0	23.5	4.6	0.0
Percent of gross official reserves	30.5	29.6	26.1	21.5	19.4	17.4	13.1	8.5	5.2	2.5	0.5	0.0
Memorandum items:												
Exports of goods and services (millions of U.S. dolla	1847	2049	2156	2403	2650	2909	3151	3401	3673	3969	4292	4644
Debt service (millions of U.S. dollars)	120.5	109.6	97.5	97.8	82.4	99.0	115.2	119.9	128.3	135.6	145.9	150.0
Quota (SDR millions)	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4
Gross official reserves (millions of U.S. dollars)	697.9	790.7	817.4	859.0	868.1	856.1	881.4	906.6	931.9	962.4	991.3	1021.1
GDP (millions of U.S. dollars)	4943	5709	6382	7030	7539	8122	8751	9442	10183	11002	11896	12848

Source: IMF staff projections.

Table 9. Malawi: Quantitative Targets 2013[1]

	Target type [2]	End-June 2013 (IT) Prog.[10]	Adj. Prog.[10]	Actual	Status	End-September 2013 (PC) Prog.[10]	Adj. Prog.[10]	Actual	Status	End-December 2013 (PC) Prog.[10]	Adj. Prog.[10]	Actual	Status
I. Monetary targets (millions of kwacha)													
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	108,487	110,839	72,920	M	87,854	59,365	81,224	NM	107,710	110,715	120,781	NM
2. Ceiling on reserve money[3]	IT	106,902	106,902	126,570	NM	110,017	110,017	134,756	NM	135,223	135,223	156,899	NM
II. Fiscal targets (millions of kwacha)													
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	-18,605	-16,253	-2,492	NM	-5,218	-2,018	58,685	NM	72,042	75,047	73,683	M
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	185,511	185,511	181,764	NM	15,330	15,330	48,952	M	106,617	106,617	105,007	NM
III. External sector targets (US$ millions, unless otherwise indicated)													
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	53	46	270	M	127	117	254	M	188	177	215	M
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	0		0	0	0	M	0	0	2.2	NM
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0	0	142	NM	0	0	0	M	0	0	145.3	NM
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0		0	0	0	M	0	0	0	M
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9,10]	PC				M				M				M
Memorandum items:													
Net foreign assets of the RBM (US$ millions)		-5		151		69		167		86		113	
Budget support (US$ millions)		245		244		50		9		27		19	
Budget support (millions of kwacha)		78,355		78,219		15,978		2,846		8,645		6,080	
Debt service payments to the World Bank and AfDB (US$ millions)		6		6		1		1		5		4	
Debt service payments to the World Bank and AfDB (millions of kwacha)		1,920		1,936		465		465		1,475		1280	
Health SWAp receipts (millions of kwacha)		11,290		15,040		3,194		4,815		6,971		3,711	
Education SWAp receipts (millions of kwacha)		23,245		1,764		4,800		3,548		9,191		13,532	
NAC receipts (millions of kwacha)		12,281		441		4,288		999		3,070		0	
Program exchange rate (kwacha per US$)		320		320		320		320		320		320	

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

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

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

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

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

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

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

[7] Defined as a cumulative flow from the biginning of the fiscal year.

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

[9] Evaluated on a continuous basis.

[10] IMF Country Report No. 14/37

Table 10. Malawi: Quantitative Targets, 2014[1]

25-Feb-15	Target type [2]	End-Mar. 2014 (IT)				End-June 2014				End-Sep. 2014 (IT)			
		Prog.[10]	Adj. Prog.	Act.	status	Prog.[10]	Adj Prog.	Act.	status	Prog.[10]	Adj Prog.	Act.	status
I. Monetary targets (millions of kwacha)													
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	113,035	115,595	117,434	NM	94,817	97,697	142,547	NM	97,701	97,701	136,885	NM
2. Ceiling on reserve money[3]	IT	134,392	134,392	169,100	NM	145,225	145,225	193,201	NM	151,232	151,232	192,097	NM
II. Fiscal targets (millions of kwacha)													
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	52,018	54,578	81,548	NM	6,622	9,502	93,147	NM	-20,023	-18,423	19,521	NM
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	170,424	170,424	167,106	NM	214,832	214,832	206,961	NM	...			
III. External sector targets (US$ millions, unless otherwise indicated)													
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	169	161	262	M	260	251	259	M	269	265	475	M
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	4.2	NM	0	0	9.2	NM	0	0	14	NM
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0	0	145.3	NM	0	0	149.3	NM	0	0	149.3	NM
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0	M	0	0	0	M	0	0	0	M
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9]	PC								M				M
Memorandum items:													
Net foreign assets of the RBM (US$ millions)		67		161		158		158		167		173	
Budget support (US$ millions)		111		35		167		67		209		67	
Budget support (millions of kwacha)		35,445		11,130		53,509		21,361		66,878		21,361	
Debt service payments to the World Bank andAfDB (US$ millions)		6		4		7		6		2		2	
Debt service payments to the World Bank and AfDB (millions of kwacha)		1,777		1,376		2,306		1,920		529		529	
Health SWAp receipts (millions of kwacha)		7,234		-4,968		8,834		-4,968		2,433		1,941	
Education SWAp receipts (millions of kwacha)		13,600		14,466		15,567		14,466		2,829		994	
NAC receipts (millions of kwacha)		3,070		1,859		4,030		3,476		971		0	
Program exchange rate (kwacha per US$)		320		320		320		320		320		320	

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

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

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

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

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

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

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

7 Defined as a cumulative flow from the beginning of the fiscal year.

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

9 Evaluated on a continuous basis.

10 IMF Country Report No. 14/37

Table 11. Malawi: Informal Quantitative Targets

	End-Sept 2014			End-Dec 2014			End-January 2015		
	Informal Targets	Actual	Status	Proj.	Actual	Status	Informal targets	Actual	Status
Ceiling on net domestic assets of the RBM (millions of kwacha)[1]	132,004	121,696	Met	84,632	66,329	Met	94,632	11,918	Met
Ceiling on central government's net domestic borrowing (millions of kwacha)[2]	8,527	19,521	Not Met	44,000	36,172	Met	46,000	58,068	Not Met
Floor on gross official reserves (US$ millions)[3]	450	457	Met	515	586	Met	500	631	Met

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

[1]NDA as reported by the RBM.

[2]Defined as a cumulative flow from the beginning of the fiscal year.

[3]Gross official reserves equal gross reserves assets as defined in the TMU.

Table 12. Malawi: Quantitative Targets, 2015[1]

	Target type [2]	End-March 2015 (IT)		End-June 2015		End-Sept 2015 (IT)		End-Dec 2015	
		Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.
I. Monetary targets (millions of kwacha)									
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	71,574		87,033		73,959		83,792	
2. Ceiling on reserve money[3]	IT	223,402		243,828		248,213		260,545	
II. Fiscal targets (millions of kwacha)									
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	59,083		37,030		40,407		58,162	
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	205,055		257,430		54,725		146,687	
III. External sector targets (US$ millions, unless otherwise indicated)									
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	475		487		531		537	
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0		0		0		0	
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0		0		0		0	
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0		0		0		0	
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9]	PC								
Memorandum items:									
Net foreign assets of the RBM (US$ millions)		378		390		433		440	
Budget support (US$ millions)		0		18		0		7	
Budget support (millions of kwacha)		0		8000		0		3224	
Debt service payments to the World Bank andAfDB (US$ millions)		8.22		12.12		3.90		7.80	
Debt service payments to the World Bank and AfDB (millions of kwacha)		3,304		4,872		1,568		3,136	
Health SWAp receipts (millions of kwacha)		15,668		15,668		2,114		14,993	
Education SWAp receipts (millions of kwacha)		1,743		3,384		0		0	
NAC receipts (millions of kwacha)		0		0		164		332	
Program exchange rate (kwacha per US$)		402		402		402		402	

Sources: IMF staff projections.

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

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

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

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

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

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

7 Defined as a cumulative flow, starting from the beginning of the fiscal year.

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

9 Evaluated on a continuous basis.

Table 13. Malawi: Structural Benchmarks set at the time of the Third and Fourth Reviews

Measure	Target Date	Macro Rationale	Status[1]
Structural benchmarks			
Public financial management			
Upload into IFMIS the audited manual transactions undertaken when IFMIS was suspended.	End-Jan. 2014	Enable better spending control an improve reporting	Not met. Some manual transactions uploaded but others pending.
Clear the backlog of reconciliation of all government-controlled accounts at the RBM and commercials banks of transactions made until November 30, 2013	End-Dec. 2013	Improve spending controls.	Not met.
Begin daily reconciliation of all government-controlled accounts at the RBM and commercial banks of transactions made until November 30, 2013	March 1, 2014	Improve spending controls.	Not met.
Submit to Fund staff final forensic audit report.	End-Jan. 2014	Establish basis for improving PFM.	Not Met. Final report submitted in September 2014
Provide Ministries, Departments and Agencies with quarterly spending ceilings consistent with quarterly fiscal targets in the program, and enforce ceilings.	Quarterly	Keep spending within available resource envelope.	Not met
Verify existing stock of government domestic arrears at end-September 2013.	End-Dec, 2013	To establish baseline for monitoring flow and stock of new arrears.	Met
Report on the flow and stock of arrears at the end of each quarter starting with July-September 2013, within two months of the end of the quarter.	February 2014, May 2014, August 2014	To monitor re-emergence of new arrears.	Not met.
Monetary Policy			
Government authorizes for RBM to stop automatic conversion of overdrafts into government securities.	End-Dec, 2013	Reduce fiscal dominance	Met
Financial sector			
RBM to publish a financial stability report on a semi-annual basis (March, September), with a lag of no more than four months.	Semi-annual; July 2013 and January 2014	Promote financial stability.	Met
Submit to parliament amendments to the Banking Act and Financial Services Act along the lines recommended by March 2013 Fund (LEG) TA mission.	31-Dec-13	Promote financial stability by enhancing RBM's bank resolution powers and tools.	Not met.
Adopt a prompt corrective action framework for banks.	31-Dec-13	Promote financial stability by strenghtening enforcement of prudential regulations.	Met
Complete the third party diagnostic assessments of the most vulnerable banks in line with understandings with IMF staff.	End-Feb, 2014	Financial stability	Not met. Diagnostic reports completed in July 2014.
Complete the third party diagnostic assessments of all banks.	30-Jun-14	Financial stability	Not met. Reports for the remaining banks were completed in October 2014.

Sources: IMF staff and Malawian authorities

[1]Status as of end-November 2014.

Table 14. Malawi: Prior Actions

Measure	Target date	Macro Rationale	Status
Prior Action			
Fiscal policy			
Implement expenditure cuts necessary to limit net domestic financing under the program ceiling for the fiscal year 2014/15 and issue a memo to cabinet outlining new expenditure ceilings.	End-February 2015	To ensure consistency between the budget and the program.	Met
Public financial management			
Ministry of Finance to issue a letter to the central bank to transfer revenues to main government account (MG1)	End-February 2015	First step towards better cash management and reconciliation of accounts.	Met
Incorporate the main government bank accounts in IFMIS, including MG1 account and the six operational accounts, namely (i) salaries, (ii) other recurrent transactions, (iii) development, (iv) statutory, (v) advances, and (vi) deposits.	End-February 2015	Integrate key accounts into IFMIS progressively to ensure an improved accounting, cash management and reconciliation of accounts.	Met
Monetary policy			
Submit to parliament legislative amendments to limit RBM's credit to government to a 10 percent of the previous year's revenue.	End-February 2015	Reduce fiscal dominance to enhance effectiveness of monetary policy.	Met
Financial sector			
Submit to parliament amendments to the Banking Act and Financial Services Act in line with those recommended by March 2013 Fund (LEG) TA mission.	End-February 2015	Promote financial stability by enhancing RBM's bank resolution powers and tools.	Met

Sources: IMF staff and Malawian authorities

Table 15. Malawi: Structural Benchmarks, 2015

Measures	Target date	Macro Rationale
Public financial management		
Publish detailed monthly budget execution data by vote on the Ministry of Finance's website no later than 6-weeks after execution.	End-March 2015	To foster greater fiscal transparency and monitoring.
Reconcile all government bank accounts MG1 and six operational accounts and ways and means for all 2014 transactions signed by the Accountant General and Secretary of the Treasury.	End-March 2015	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.
Review all bank accounts and close redundant and dormant accounts and provide an updated list from the central bank certified by the Accountant General.	End-March 2015	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.
Prepare a report on the flow and stock of arrears at the end of each quarter starting with with end-September 2014 and within two months of the end of each six months.	End-June 2015	To monitor emergence of arrears.
Produce and publish monthly summary bank account control reports.	End-September 2015	To improve transparency and control.
Issue reports by international audit firms on bank reconciliations and summary bank account control reports.	End-September 2015	To improve transparency and restore public confidence.
Issue a report by an International firm confirming the status of implementation of forensic audit recommendations in the PFM domain.	End-December 2015	Foster greater transparency.
Financial sector		
Prepare a strategy to address banking sector wide issues raised by the third-party diagnostics assessments, including the high loan concentration among banks.	End-March 2015	To safeguard the stability of the financial system.
RBM to obtain from all undercapitalized banks to submit detailed, quarterly monitorable recapitalization and restructuring plans showing how they will reach the minimum capital adequacy level within one year.	End-April 2015	To safeguard the stability of the financial system.
RBM to obtain from all banks with significant deficiencies (e.g.: on loan documentation) reported by the diagnostic assessments to submit plans to address the deficiencies within one year.	End-June 2015	To safeguard the stability of the financial system.
RBM to develop contingency plans to intervene and resolve banks if they do not submit or comply with acceptable recapitalization plans.	End-June 2015	To safeguard the stability of the financial system.
Submit to parliament amendments to the AML/CFT Act, the Penal Code, and the Corrupt Practices Act in line with the FATF standard and the United Nations Convention against Corruption (UNCAC).	End-June 2015	To ensure that: (i) enhanced customer due diligence is required with regard to domestic politically exposed persons ; (ii) suspicious transactions are reported when there is a suspicion that funds are the proceeds of a criminal activity ; (iii) there is adequate transparency of legal persons and arrangements; (iv) acts of corruption are adequately criminalized and constitute predicate crimes to money laundering; (v) self-self-laundering is criminalized, and (vi) there are appropriate administrative sanctions for failure to comply with AML/CFT requirements.
RBM issue a detailed report on compliance with regulations on loan classification and provisioning and concentration limits in line with existing directives.	End-September 2015	To safeguard the stability of the financial system.
RBM, in its supervisory capacity, to follow-up on possible breaches of compliance with the AML legal framework by banks revealed by the audit report, by applying supervisory actions mandated by the AML legal framework with regard to any breaches of compliance, including sanctions.	End-December 2015	To ensure compliance with AML standards.

Sources: IMF staff and Malawian authorities

Appendix I. Progress in Implementing the Government's Short-Term Action Plan

The status of implementation of selected actions in the Government's Action Plan is summarized in the table below, based on the government's implementation matrix based on the interim forensic audit report.

ACTION	STATUS
Investigation and Prosecution	
Profiling of properties and restrictions on assets. [Anti-Corruption Bureau.].	• Assets (e.g., houses, vehicles and farms) of several public officials have been profiled. • 60 out of 81 companies identified in investigations have been profiled. • Restrictions have been imposed on access to 50 bank accounts. • Restrictions have been imposed on the disposal of properties (e.g., houses, vehicles, land) of several persons/entities under investigation.
Prosecution of cases. [DPP and ACB].	• 53 case files being used to pursue prosecutions. Three convictions to date and MK185 million in assets recovered. • Prosecutions will also be pursued under Section 88 of the PFM Act governing offences and discipline. • Joint investigate teams established among ACB, DPP, Financial Intelligence Unit and Malawi Revenue Authority.
Auditing	
Undertake preliminary forensic audit covering April-September 2013.	A preliminary report of the audit was submitted to government on February 21 2014. Report was submitted to Parliament on February 24 by the Minister of Finance. Final report made Public on October 30, 2014.
Undertake comprehensive forensic audit including forensic audit of arrears.	Price Water House Coopers has been identified to carry out the Forensic Audit covering the period July 2009 to March 2014. This will be done with financial support from the German Agency for International Cooperation.
The Auditor General to table all reports from investigations and special audits in Parliament for action by the Public Accounts Committee.	Preliminary forensic audit report was submitted to Parliament on February 24. Final report submitted to Parliament.

ACTION	STATUS
Institutionalize pre-auditing.	Government Circular issued on the introduction of pre-auditing.
Accounting	
Review the system's security gaps and enhance system controls.	• Security features enhanced. • Physical access to IFMIS server room has been secured and stronger controls issued to limit system administrator access.
Enter into Service Level Agreement (SLA) with the software company for provision of functional and technical support including overseeing IT functions.	• Draft Service Level Agreement (SLA) negotiated • The SLA will define the specific terms as outlined in the contract between GoM and Softech including targets to be achieved and time frame. The new SLA is for the period January to June 2014.
Engage an ICT Security Officer.	Officer recruited and commenced duties on November 1, 2014.
Appoint an IFMIS Manager to oversee the application side.	IFMIS Manager at Deputy Director level was appointed by Government and an IFMIS Advisor was recruited with the support of the Germany.
Issue and enforce internal circular emphasizing controls surrounding payments and printing of checks within Accountant General Department.	A circular reference number OA/1/15/13/270 dated 19th September 2013 was issued by the Secretary to the Treasury. Circular issued by Accountant General.
Reconciliation of all Government accounts at RBM and commercial banks by December 31, 2013.	Reconciliation of the backlog done to end December 2013. A report of items that did not automatically reconcile has been submitted to internal audit for follow up. Internal audit has investigated un-reconciled items for the period July 2012 to December 2013 and will continue to investigate for June 2012 to July 2012.
Embark on daily bank reconciliation.	Not done. FAD TA mission has made a number of recommendations.
Circulate daily IFMIS- generated check list to RBM and commercial banks.	• The Accountant General's Department has started circulating daily IFMIS generated electronic check list to the RBM and commercial banks. • A check dispatch list generated by IFMIS is sent to RBM and RBM in turn posts it on a platform accessible by all commercial banks. • Commercial banks are clearing checks through the IFMIS generated check lists.
Improve dialogue between RBM, Accountant General, and Treasury.	Cash management Committee has been revived and is chaired by the Secretary to the Treasury.

ACTION	STATUS
Implement systems to enforce funding ceilings with IFMIS and the RBM.	Instructions issued to RBM and capping began in January 2014.
Independent verification of the IFMIS system by appointing 4-5 consultants to the AGD to provide oversight and pre-audit services.	• Two independent firms/consultants were recruited with EU support and have since finalized their work. • There were some improvements in internal controls but more needs to be done.
Carry out an independent audit for payments made during the tenure of the manual system by end December 2013.	• Internal audit report issued in December 2013 • Ministry of Finance/Accountant General considering the recommendations from the audit report • All the manual payments have been captured into IFMIS and reconciliation of the same is underway
Administrative Measures	
Disciplinary action for implicated officials (e.g., approvers of fraudulent payments and check signatories).	2 principal secretaries and 18 accounting personnel have been suspended.
Rotation of staff.	• Some officers have been posted to fill posts in ministries where suspects have been interdicted. • Some officers whose roles are not clear have been posted to other ministries to pave the way for full investigations. • 16 IT personnel have been posted out of the Accountant General's Department.
Enforce the Malawi Public Service Code of Conduct.	• Training envisaged under FAD PFM recommendations.
Enforce accountability of controlling officers and heads of departments/agencies in line with Public Finance Management Act, Public Audit Act, and Public Procurement Act.	• The Department of Public Sector Reforms Management (PSRMU) in OPC has drawn a training program for all ministries, to Controlling Officers and their staff in Ethics. • The workshops on Ethics are underway. In March 2014 the following sessions were conducted: Training of Trainers (31 participants); High Level Consultation on Strengthening National Integrity and Accountability for all Principal Secretaries and Heads of Constitutional and Independent Bodies (44 participants); Ethics training for Directors of Finance, Human Resource, Administration, and Technical Directors Chief Accountants, and Chief Systems Analysts (135 participants).

ACTION	STATUS
	• During the workshops all participants are required to sign a commitment to compliance with the Code of Conduct and Ethics, and this will be linked to an enforcement of prevailing rewards and penalties. • The other group of participants will be trained from April to June and this will be a continuous process to December 2014. Participants commit to comply by signing declaration.
Legal and Institutional Reforms	
Amend Money Laundering Act (including civil assets forfeiture direct access to financial information by Financial Intelligence Unit).	Amendments proposed and discussions are ongoing between FIU/MoF and Ministry of Justice. Now a benchmark.
Assets Declaration bill.	Was passed by parliament and signed into law by the President. Assets Declaration Act was assented to and has since been gazette.
Accelerate implementation of Public Finance and Economic Management Reform Program.	A number of initiatives being undertaken through the Financial Reporting and Oversight Improvement Project including assessment of the Government Wide Area Network (GWAN) to improve access and availability of the GWAN, support toward the IFMIS through the engagement of the Softec, Epicor based IFMIS suppliers, Business Re-engineering Processes, facilitating trainings for the accounting and auditing personnel in order to improve their competencies as well as procurement of equipment to improve hardware infrastructure for effective operations of the accounting, payroll management, internal audit and external audit functions.

Appendix II. Letter of Intent

March 4, 2015

Madam Christine Lagarde
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, D.C. 20431
United States

Dear Madam Lagarde:

On January 17, 2014, the Executive Board of the International Monetary Fund (IMF) completed the third and fourth reviews under the three year Extended Credit Facility (ECF) arrangement for Malawi. At the same time, the Board extended the arrangement to November 2015. This letter and the attached Memorandum of Economic and Financial Policies (MEFP) report on recent economic developments and performance under the ECF arrangement since that time, and on the policies we plan to implement in the remainder of fiscal year 2014/15 and over the medium term.

The new government of Malawi, led by Professor Arthur Mutharika, assumed power last year in a very challenging economic environment. The large scale theft of public funds uncovered in late 2013—dubbed the "cashgate" scandal—exposed substantial weaknesses in our public finance management (PFM) systems and severely impacted our macroeconomic situation. The immediate effect was a suspension of all donor budget support, then valued at about 5 percent of GDP. As a result the fiscal situation became dire, and difficulties were compounded by an increased recourse to domestic financing. Domestic payment arrears emerged, inflationary pressures persisted and the exchange rate depreciated sharply.

Since that time, we have made significant efforts to stabilize our macroeconomic situation, regain control over our PFM systems, and safeguard the stability of our financial sector. We are confident that these ongoing efforts will restore private sector confidence in our policy stance, place inflation on a downward trajectory, and foster growth-promoting private investment.

We remain committed to the objectives of the original ECF-supported program, namely attaining strong inclusive growth, single digit inflation, and an increase of reserves to at least three months of import cover. Important to these ends will be preservation of our flexible exchange rate regime and automatic fuel pricing mechanism, both of which have served us well since 2012. We will continue to implement a tight monetary policy stance capable of forcing inflation onto a clear downward trajectory and will maintain positive real interest rates throughout the program period. Our fiscal program for FY2014/15 is calibrated to support such a strong disinflation effort and to restore private sector confidence in our ability to control fiscal expenditure and safeguard debt sustainability. We are combining this firm macroeconomic policy stance with the implementation of a far-reaching strategy to address weaknesses in our PFM system.

We are requesting waivers for the nonobservance of one periodic performance criterion (PC) related to the fifth review (end-December test date) and two periodic PCs for the sixth review (end-June 2014 test date) that were not met. The PCs on net domestic assets of the central bank and net domestic borrowing were missed mainly because of the difficulties arising from ongoing external financing shortfalls and uncertainties surrounding our recent tripartite elections.

The continuous ceilings on external payments arrears and on non-concessional debt were not met following the contracting and subsequent nonpayment of external obligations on a supplier's credit for military equipment. With regard to the contracted non-concessional credit, we have taken remedial actions by renegotiating the supplier's credit agreement, reducing substantially the value of transactions value of transactions with the supplier from US$145.3 million to US$33 million and have also taken further remedial measures to improve debt management capacity. With regard to the external payments arrears, we have normalized the outstanding arrears as explained in our February 19 letter, in response to your February 12 letter. On the basis of our remedial actions, we are requesting a waiver for the nonobservance of the performance criteria on the contracting of non-concessional external debt with a maturity of more than one year and on the accumulation of external payments arrears that resulted in non-complying disbursements.

The continuous ceiling on new non-concessional external debt maturing in more than one year was also not met due to the contracting of two non-concessional loans: (i) a supplementary loan for the rehabilitation of an inter-city road, which became effective in April 2014; and (ii) a loan we contracted in February 2015 for the construction of a cancer treatment center in Lilongwe. Efforts to obtain better terms for the infrastructure loan were unsuccessful and the government decided to go ahead with the loan on the grounds that it was relatively small (US$4 million), but also because it was critical to addressing Malawi's infrastructure gap and necessary to avoid accumulation of arrears to the contractor. The construction of a cancer treatment center is a critical addition to Malawi's health care infrastructure, as the incidence of cancer is rising quickly and the cost of referring patients to foreign hospitals is extremely high. The loan, (US$13 million), was negotiated with the OPEC Fund for International Development. It carries a 29 percent grant element and was only agreed after exhausting efforts to secure more concessional financing from other development partners.

Going forward, we are committed to take measures to improve our ability to monitor the concessionality of new external loans and to strengthen debt management in general. To these ends, we are resuscitating the Debt Management Committee. With members drawn from senior civil servants, this committee will be responsible for ascertaining the concessionality of every borrowing proposal, with a view to safeguarding debt sustainability and ensuring that all loans remain compliant with the Public Financial Management Act. We will discuss with Fund staff all new loan proposals before they are brought to the attention of the Cabinet or Parliament and ensure transparency of the grant element of loan proposals. We also will continue implementing the Debt management reform programme that was agreed with the IMF and World Bank, which is aimed at strengthening our debt management capacity. On this basis, we request a waiver for the nonobservance of the continuous ceiling on new non-concessional external debt with a maturity of more than one year.

We have undertaken the following prior actions before consideration of the fifth and sixth ECF arrangement reviews by the IMF's Executive Board: (i) implementation of expenditure cuts necessary to limit net domestic financing under the program ceiling for the fiscal year 2014/15; (ii) issuance of a letter to the central bank to transfer revenues to the main government account; (iii) inclusion of our main government accounts (MG1 and the six operational accounts) in our information management system; (iv) submission to Parliament of legislative amendments to limit RBM's credit to government to 10 percent of the previous year's revenue; and (v) submission to Parliament of amendment to the Banking Act and the Financial Services Act in line with those recommended by March 2013 Fund TA mission.

On the basis of our overall performance, the corrective actions that are being taken, as well as the strength of policies set forth in the attached MEFP, we request that the Executive Board of the IMF complete the fifth and sixth reviews under the ECF arrangement and release the sixth and seventh tranches totaling SDR 13.02 million. We also request an extension of the arrangement by 6 months to May 22, 2016 to allow for the completion of the eighth review, as well as the rephasing of the remaining disbursements under the arrangement.

We believe that the policies set forth in the attached Memorandum of Economic and Financial Policies are adequate to achieve the objectives of the program, but we will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures, and in advance of any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. Moreover, we will provide the IMF with such information as they request in connection with progress in implementing our policies and obtaining the objectives of the program.

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

Yours sincerely,

/s/	/s/
Mr. Goodall Gondwe, Minister of Finance	Mr. Charles Chuka, Governor of the Reserve Bank of Malawi

Attachments:

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

Attachment I. Memorandum on Economic and Financial Policies for the Fifth and Sixth Reviews under the ECF Arrangement

March 2015

BACKGROUND

1. This memorandum supplements the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated December 26, 2013. It describes recent developments and performance under the ECF-supported arrangement since completion of the third and fourth reviews in January 2014. It also elaborates on the policies and structural reforms we intend to carry out in the year ahead to regain macroeconomic stability, improve our public financial management systems, and safeguard financial sector stability.

2. Tripartite elections at all levels of Government were held in May 2014. Despite some logistical issues, these elections were considered by independent observers to have been free and fair. Following the elections, a new Government, led by Professor Arthur Peter Mutharika, assumed power and committed to correcting macroeconomic imbalances and setting the country on a path to sustainable and inclusive noninflationary growth. In the sections below, we describe our policy agenda for significantly enhancing and accelerating our macroeconomic and structural reform process. Some of the modalities we intend to adopt represent a departure from those of the previous Government, a change largely motivated by altered circumstances and, in some cases, a more realistic evaluation of implementation capacity. The differences mainly reflect a recasting of priorities, but the underlying aim of rapidly regaining macroeconomic balance, rebuilding government fiscal systems, improving financial sector stability, and achieving our growth potential remains unchanged. We also remain committed to the fundamental reforms adopted in 2012 that established a flexible exchange rate and automatic fuel pricing mechanism, as we view these as necessary and appropriate to Malawi's present economic circumstances.

RECENT ECONOMIC DEVELOPMENTS AND NEAR TERM OUTLOOK

Impact of the "Cashgate" Scandal

3. The discovery of the theft of government funds in late 2013—dubbed the "Cashgate" scandal—revealed deficiencies in our fiscal systems on a scale previously unsuspected. Following the discovery, measures to improve our public financial management (PFM) system were adopted in October 2013 in the form of a Government Action Plan, which was developed in consultation with, and generously supported by, development partners. In March 2014, an independent assessment was made on 39 actions that were due for monitoring and verification. The assessment indicated that 22 of 66 actions were met, progress had been made on 10 others, 1 was not met and 6 could not be assessed. However, an internal assessment of these actions was done in October 2014 and showed that 48 actions were met, there was progress on 12 actions and 6 actions were yet to be met. Notwithstanding this progress, we realize that

achieving credible and reliable PFM systems will require a more strategic and results based-approach.

4. One of the main undertakings of the government's Action Plan was the commissioning of an external forensic audit with financial assistance from DFID. An interim report was issued in February and the final report was delivered to Government in October 2014. In addition to providing details of the illicit transactions uncovered—details that are now being used by our law enforcement agencies to carry out prosecutions and to effect recovery of stolen funds—the reports also provided insight into the deficiencies of our PFM system that had allowed the thefts to take place. This analysis, supplemented by technical assistance from the IMF and the donor community, has been helpful to us in designing a comprehensive action plan, with a well thought out design and sequencing of reforms, which we intend to vigorously implement over the remaining period of our IMF-supported program (see below). Currently, Government has engaged Price Waterhouse Coopers International to carry out comprehensive forensic audit on the Epicor System for the period 2009 to March 2013 with assistance from GIZ. Furthermore, Government has engaged private auditors to conduct comprehensive forensic audits on all independent sites (sub IFMIS systems) which include: State Residences, Malawi Defense Forces and the Malawi Police.

5. The "cashgate" scandal interrupted what would otherwise have been a period of economic recovery. After some initial trepidation following the floating of the exchange rate in May 2012, and the subsequent depreciation that followed, markets in Malawi had begun to see the substantial benefits of the new exchange rate regime. They had also come to recognize that the automatic fuel pricing mechanism had been responsible for eliminating the fuel shortages of the previous year. Following a good tobacco season in March-August 2013, substantial reserves were accumulated and this, combined with monetary tightening, had arrested the decline of the exchange rate. Inflation was on a downward trend, growth prospects appeared good and, with rising private sector confidence, we anticipated further macroeconomic stabilization and strong growth over the coming year.

6. The outbreak of "cashgate" significantly changed this outlook, and the suspension of budget support that followed continues to impact our macroeconomic position. With our budget for FY2013/14 heavily reliant on these cash disbursements, their sudden withdrawal necessitated fiscal adjustment on a scale that overwhelmed our weakened PFM systems. As a result, domestic borrowing limits were exceeded, and large domestic payments arrears accumulated. With the Reserve Bank financing a substantial portion of the government's borrowing requirement, and with incomplete sterilization of foreign exchange reserve purchases, liquidity control became problematic. This led to un-programmed increases in reserve money and net domestic assets (NDA) of the Reserve Bank of Malawi (RBM) that compromised our disinflation program. Moreover, the loss of the foreign exchange associated with budget support and dedicated grants, in the absence of complete fiscal adjustment, also slowed reserve accumulation from what could otherwise have been achieved.

RECENT ECONOMIC DEVELOPMENTS

7. As of the final quarter of 2014, the macroeconomic situation remains mixed. Growth has shown considerable resilience, but inflation and recent exchange rate movements are worrisome. With the protracted period of uncertainty, private sector confidence has been eroded, and inflationary expectations remain high.

- Growth has held up so far in 2014, with preliminary indications that real GDP growth will increase from 5.2 percent in 2013 to about 6 percent in 2014, led by strong outcomes from the agriculture, wholesale/retail trade, and information and communication sectors. The ready availability of foreign exchange and fuel appear to be continuing to support the recovery in economic activity. All major sectors of the economy are projected to register positive growth except the mining sector which will be adversely affected by the suspension of uranium production at Kayerekera mine since June 2014.

- International trade remains strong. Exports are set to grow by 7 percent during 2014, driven by a recovery in tobacco production as well as continued export growth in traditional (tea, sugar, cotton) and nontraditional commodities (such as edible nuts). Growth in these sectors is expected to compensate for the closure of the Kayelekera Mine, which by 2013 was exporting the equivalent of one-third of total tobacco exports. Imports are expected to grow slowly at about 3.7 percent during 2014, sustained in part by the imports required by a large power plant investment Kapichira II. Overall, both the merchandise and services deficits are expected to improve during 2014.

- The fiscal situation has been challenging. The “cashgate” scandal not only necessitated a sharp curtailment of programmed expenditure, but it also undermined trust in public financial management systems and raised concerns that the budget was not fully financed. In the event, with annual shortfalls in external disbursements amounting to almost 6.6 percent of GDP, our PFM systems proved too weak to enforce the discipline needed to follow the adjustment path agreed under the program. By the end of the 2013/14 fiscal year, domestic financing rose to about 6 percent of GDP and payment arrears (1.7 percent of GDP) had accumulated an amount substantially above our target level. Compounding the issue, we have also uncovered additional arrears that had been accumulated by the previous Government over the past several years.

- The disinflation process stagnated in 2014 and inflation at end-2014 remained elevated, at 23 percent (year-on-year). This reflects, in part, high liquidity levels from largely unsterilized foreign exchange purchases during the tobacco season, and from some financing of the FY2013/14 fiscal deficit by the Reserve Bank of Malawi (RBM). In July 2014, in anticipation of a more favorable outlook for inflation, the RBM lowered its policy rate by 250 basis points to 22.5 percent. In retrospect, we now believe this move was somewhat premature, as the annual inflation rate accelerated over the subsequent two months rendering the policy rate negative in real terms. Since this was sending a conflicting signal to the market, we subsequently raised the rate back to 25 percent on October 30th. We believe this level is sufficiently positive in real terms to send appropriate signals to the private sector regarding our commitment to the disinflation process. This measure was followed by a directive restructuring the liquid reserve ratio (LRR) by requiring that the current LRR (15.5 percent) be imposed on foreign currency deposits in local currency rather than in foreign currency. This became effective on November 10, 2014, and is contributing to the absorption of liquidity from the banking system.

- Interest rates on bank loans have remained elevated, and this has reduced the growth of private sector credit sharply. Anecdotal evidence suggests this is increasingly restricting new business investment which, combined with reduced real incomes from the inflation, will affect growth going forward. Evidence from the third-party diagnostics of individual banks suggests there has also been some impact on the health of the banking sector as non-performing loans have risen steadily since end-2012 and now stand at 15.8 percent of gross loans.

- The exchange rate came under considerable pressure and depreciated by 15 percent in 2014. This is in part a seasonal phenomenon, as the rate usually weakens after the end of the tobacco buying season in August. However, it has been particularly acute so far this year, owing to the unattractive level of real kwacha interest rates prevalent up to November, and shortfalls in external financing. International reserve levels have reached a relatively healthy level of 2.9 months of import cover in December, but remain below our target level of three months. As it did last year, the RBM purchased substantial reserves during the 2014 tobacco buying period, helping to smooth exchange rate volatility during the first half year of 2014.

- Malawi's external public debt to GDP ratio is growing and is expected to reach 32 percent of GDP in net present value terms at end-2014. Nonetheless, this is not expected to worsen the debt dynamics significantly, as external debt remains mostly concessional. Our external debt service burden remains low, with a debt service ratio in 2014 of only 4.7 percent of exports of goods and services. In contrast, our domestic debt burden is becoming more worrisome due to increased recourse to domestic financing over the last two years, and from our recent decision to securitize past domestic arrears. As a result, total public debt as a share of GDP is set to reach 75.8 percent of GDP at end-2014.

PERFORMANCE UNDER THE PROGRAM

8. As a result of these developments, a majority of the periodic quantitative targets for end-December 2013 (fifth review test date) and end-June 2014 (sixth review test date) under the program were missed. The exception was the performance criterion on net international reserves (NIR), which was met comfortably for both test periods. In the first period, this was the result of the RBM refraining from exchange rate intervention after the end of a strong tobacco season in August 2013, as it preferred to maintain—at a cost of some exchange rate depreciation—a prudent level of reserves. The end-June 2014 target on NIR was met from the carry over effect of this, but also because of another strong tobacco season in mid 2014. However, incomplete sterilization of these purchases increased system liquidity and pushed NDA and reserve money of the RBM above program targets in both December 2013 and June 2014. The performance

criterion (PC) on net domestic borrowing by government was met for the December 2013 test date but, as spending pressures became acute in the second half of the fiscal year, control over expenditure suffered and additional borrowing was undertaken that breached the end-June 2014 program ceiling. The indicative target on social spending was also missed, in part because of lower spending on the Farm Input Subsidy Program (FISP).

9. The continuous ceiling on the accumulation of nonconcessional external debt was missed, due to: (i) the contracting in October 2013 of a medium-term nonconcessional suppliers' credit; (ii) the contracting in April 2014 of a supplementary loan for the rehabilitation of the Liwonde-Naminga road and (iii) the contracting in February 2015 of a loan for the construction of a cancer treatment center in Lilongwe. The continuous ceiling on external payments arrears was also missed as of October 2013 due to arrears incurred on the supplier's credit loan. The above mentioned supplier's credit with the Paramount group in 2013 was to acquire military equipment. Proceeds from the sale of the presidential jet in 2013 were used to make partial restitution of overdue payments on this credit agreement. On coming into office, however, the new Government determined that this contract was an anomaly and took steps to exit the agreement. To this end, we have renegotiated the contract so that it only includes equipment that has either been already delivered or currently in the production line, resulting in a reduction in the total value of the arrangement from $145.3 million to $33 million. We wish to reassure the Fund that the present government is committed to the PFM Act and that transactions and contracts of this nature will not be repeated in.

10. The supplementary loan for the Liwonde-Naminga road is relatively small (US$4 million) and was contracted with a relatively high grant element of 29 percent. We indicated to the Fund our intention to obtain financing for this project in order to close the financing gap in the project as agreed in the remedial measure of our current program. However, efforts to obtain better terms or financing from additional concessional lenders were unsuccessful. A decision to continue with the project was then made on the basis of its small size, that the government had already engaged a contractor, the strategic importance of this road, and the fact that it will not affect debt dynamics significantly or persistently. Moreover, delaying payments to the contractors would have incurred higher costs in terms of idle time, contract extension and penalties. The Government realized that this loan was nonconcessional but considering that works on the road had stalled, it would have been costly to terminate the contract with the contractor in view of the fact that the amount required to complete the road was small. Litigation and interest costs would have made the project even more costly than US$4 million. Furthermore, considering the strategic nature of the road, Government was determined to complete the works on the road because the works started a long time before the current program. Government made this borrowing on the basis on necessity and we undertake to stick to the agreed non-concessional borrowing for any future projects.

11. The ceiling on new nonconcessional external debt maturing in more than one year was also missed with the contracting of a loan in February 2015 for the construction of a cancer treatment center in Lilongwe. In Malawi Data from the cancer registry is showing that new cancer cases are rising quickly and the proportion of patients living with cancer and requiring continuous treatment is rising even faster. Chemotherapy, when available, is very expensive and is about $1400 per treatment. This is beyond the reach of the average Malawian. Radiotherapy is a more affordable and appropriate palliative modality for cancer patients. It is envisioned that the

National Cancer Centre will be an outpatient radiotherapy and chemotherapy referral centre, catering for both fee paying and non paying patients. The proposed project will provide a cost efficient national and regional cancer centre drawing patients from around Malawi and neighboring countries. The National Cancer Centre is also expected to become a centre for learning, incorporating resources such as a joint hospital/cancer centre library and learning centre, along with facilities to enable the development of partnerships with nursing and medical schools. The loan, which amounts to US$13 million), was negotiated with the OPEC Fund for International Development and carries a 29 percent grant element. It was only agreed after exhausting efforts to secure more concessional financing from other development partners.

12. Under the Health SWAP 1, the Government made a plea to Development Partners to have the cancer project be included as part of the critical infrastructure needed for improved health. However Development Partners wanted the integration of cancer issues within the existing health delivery mechanism than a standalone facility. Realizing the high costs of cancer treatment in terms of referrals outside the country, in 2010 Government decided to finance the cancer centre using local resources and most of these funds were used on studies and obtaining approval from International Atomic Energy Agency (IAEA). After failing to secure funding from any of the traditional development partners whose funding is concessional, it was only OFID that agreed to finance this life saving facility (US$13 million). Just like all other OFID loans the Grant Element is 29 percent and the Government considers this very close to the grant element of 35 percent that is recommended by the Fund.

13. Progress on structural reform under the program has been uneven. We have verified the stock of government domestic arrears for 2013/14 financial year and those accumulated in previous years. The total stock of arrears stands at K157 billion (8 percent of GDP). However, as these numbers were very large and because some of the claimants are mentioned in the forensic audit report, we have asked the Auditor General to repeat the entire audit. Regarding arrears accumulated during FY13/14, further work is needed to verify that some of the infrastructure works presented in the claims were actually carried out. Government has authorized the RBM to stop the automatic conversion of overdrafts into government securities. This significantly reduced the stock of treasury bills held by the central bank, but had little effect on curbing the accumulation of government debt held in the form of advances. The RBM has regularly published a quarterly financial stability report, we have adopted a prompt corrective action framework for bank resolution, amendments to the RBM Act were submitted to Parliament (prior action), and third party diagnostics were completed for every bank in the system.

14. The forensic audit of the "Cashgate" period was completed and the full report was made publically available, and prosecutions of malefactors and recovery of stolen funds has begun and has met with some initial success. We are using the 53 case files arising from the forensic report to prosecute those individuals involved in theft of state funds and money laundering. To date there have been five convictions and MK 183 million has been recovered so far. With the assistance of an external asset recovery expert financed by the U.K we will endeavor to increase the efficacy of recoveries as prosecutions proceed. Investigative agencies, namely the Anti Corruption Bureau, Financial Intelligence Unit, the Financial Fraud Unit of the Malawi Police Force and the Malawi Revenue Authority are closely collaborating in getting evidence to pursue prosecutions under the Penal Code, the Corrupt Practices Act, the PFM Act and the Anti-Money

Laundering framework. In recognition of gaps in the legal framework we will request technical assistance from the Fund in amending some of these acts.

15. Given "out of scope" transactions highlighted by the forensic audit report (transactions outside the auditors' remit to investigate cashgate transactions) , we have now harmonized procurement across the public sector and will conduct an audit of these transactions in each ministry. Auditors from the private sector will be employed to complement our existing audit function which will be centralized within the Ministry of Finance. To reinforce compliance with obligations under the PFM Act, controlling officers in each ministry and senior civil servants will be required to attend a series of workshops on the responsibilities and sanctions under the PFM Act. Moreover, all controlling officers will be issued with appointment letters with revised terms of reference. In addition to benchmark progress we will issue a report by an audit firm confirming the status of implementation of the forensic audit recommendations (end-December benchmark).

16. On a number of other structural commitments work has progressed, but closure has proved difficult. We have uploaded into IFMIS most of the manual transactions undertaken when our systems were suspended in October-November 2013. However, the completion of this exercise was delayed due to the pending validation of these transactions. The reconciliation has shown that few votes have still not been finalized in capturing their expenditures into the system. We have thus set a deadline of end-February 2015 as a final date of completing this assignment. Similarly, progress has been made towards doing daily reconciliation of government accounts with the RBM beginning January, 2014, but due to technical problems of Epicor based IFMIS it has been difficult to finalize adjusting the unreconciled items into the system. However, a 15 member team was assigned to manually do the reconciliation from 10th November, 2014 and we are hopeful that the assignment will be finalized by the end of February, 2015. As regards the follow up on the backlog, the Central Internal Audit Unit will finalize its work by end-February, 2015. We have not provided Departments and Agencies with quarterly spending ceilings, as we felt our resource envelope was too constrained, but we have continued to issue monthly ceilings. Moving to quarterly ceilings which will increase spending efficiency remains our intention and we will implement this soon as feasible. We also encountered administrative delays in submitting amendments to the Banking Act and Financial Services Act to Parliament.

17. Performance on the macroeconomic level since mid 2014 has been significantly better. In order to anchor monetary and fiscal policies, we agreed on informal targets with IMF staff for end-September and end-January 2015 on gross international reserves, net domestic assets of the RBM and government net domestic borrowing. While we missed the end-September 2014 target on net domestic borrowing, all others were met. Furthermore, we have carried out a number of structural measures, described below, as prior actions for completion of the fifth and sixth reviews.

OUTLOOK AND KEY ECONOMIC OBJECTIVES

Key Goals

18. We remain committed to the objectives of the original program including increasing reserve cover to at least three months of imports and reducing inflation to single digits. Our overriding short-term goals are to stabilize our macroeconomic situation, regain firm control over our fiscal systems, and safeguard the stability of the financial sector. These are necessary conditions that must be met if we are to successfully address Malawi's pressing development needs in the years ahead. Responsible fiscal and monetary policy combined with vigorous PFM reform are needed to restore confidence in the budget, reduce inflation, reverse the contraction of real incomes, and foster the private sector confidence needed to encourage growth-promoting investment.

19. To this end, we recently raised our policy rate from 22½ percent to 25 percent, a move that significantly tightened our monetary policy stance. We are supporting this measure with appropriate liquidity operations to ensure that the rate increase translates into an upward shift in other key interest rates and establishes sharply positive real interest rates throughout the economy, with particular attention to the rates on treasury bills. Concurrently, we have embarked on a series of accelerated PFM reforms designed to quickly regain control of our fiscal operations so that our stabilization program is not forced off track by unauthorized spending or by a further accumulation of arrears.

MACROECONOMIC OUTLOOK AND RISKS

20. We view a restrictive policy position as necessary in the short term to stabilize our economy, but we recognize that this will exert a cost in near-term growth. Support from lower international prices for food and fuel and a stronger currency will assist in bringing inflation to single digits over the next 12 to 15 months. This will dampen growth somewhat in 2015. However, concurrently with this, we anticipate a steady increase in private sector confidence, as agents come to acknowledge that fiscal control is being regained, and that the stance of policy is leading us towards a sustainable macroeconomic position. Moreover, maintenance of positive real interest rates will begin to improve the attractiveness of the kwacha as a currency of investment. This should provide some relief to the exchange rate pressures recently experienced, as well as providing us with an additional policy tool, going forward, for limiting intra-year exchange rate volatility. As confidence, and subsequently investment and consumption levels gradually rises, we would expect activity to begin accelerating towards the end of the calendar year, setting the stage for sustainable, low inflation in 2016 and beyond.

21. We therefore view 2015 as a year to consolidate our position and lay the groundwork for a period of sustained noninflationary growth. Real growth in 2015 is expected to reach 5.5 percent (one percentage point lower than anticipated in our December 2013 MEFP) and to gradually increase to 6 percent in 2017. Inflation will decline to 12 percent by end-2015 and single digit levels towards end-2016. Fiscal restraint and a reliance on concessional foreign borrowing for the majority of our finance needs will allow some reduction in the stock of domestic debt relative to GDP to take place. Strong debt management in the near-to medium term will be implemented to ensure that debt is sustainable and the right balance of costs and

risks is achieved. This will be attained by resuscitating the Debt Management Committee whose membership will be at senior level, which will look at each borrowing, to ascertain its concessionality and to insure debt sustainability. The Government will also continue implementing the Debt Management Reform Programme, that was agreed with IMF and World Bank that is aimed at strengthening the debt management capacity of the Debt and Aid Management Division. We aim to achieve a level of international reserves of at least 3.3 months of import cover by 2016 for general prudential purposes and in order to be better equipped to smooth seasonal fluctuations in the currency. Under a setting of macroeconomic stability, recovering growth, and higher confidence in the domestic currency, we expect the current account deficit to decline by about 1.7 percentage point of GDP by the end of 2015.

POLICIES

Fiscal Policy

22. Our fiscal program for FY2014/15 is calibrated to support a strong disinflation effort and to re-establish private sector confidence in our ability to control fiscal expenditure and safeguard debt sustainability. In an effort to catalyze confidence quickly by enhancing transparency, we will begin the regular monthly publication of our detailed fiscal operations. In light of the significant fiscal risks and uncertainties we face in the year ahead, we have introduced a number of adjustments and contingencies to our approved budget to ensure orderly execution. A circular informing Cabinet of these adjustments was issued as another prior action for completion of the reviews. When fully executed, this adjusted budget will result in about a 2¾ percentage points of GDP improvement in the overall balance relative to last year.

- We have conservatively estimated total revenue at 33 percent of GDP, about ½ percentage points higher than last year. Tax revenue is projected at 0.5 percentage point of GDP below the outturn for last fiscal year to reflect uncertainties in the economic outlook. This is offset by an increase in foreign—mostly project—grants. Furthermore in a bid to enhance compliance and improve mobilization of domestic resources for Government, the Malawi Revenue Authority (MRA), is undertaking a Modernization Program under the theme "Innovation and Modernization". The reforms and initiatives under this program are aimed at improving tax compliance in domestic taxes, promoting the use of enhanced ICT services which include electronic fiscal devices (EFD), and cargo scanners; and widening the tax registration net, among other benefits.

- We have programmed significant adjustment on the expenditure side, where total outlays at 38.9 percent of GDP represent a decline from last year of 2 percentage points of GDP. The majority of this adjustment—5½ percentage points of GDP—falls on current expenditure. In addition to savings of 0.6 percentage points of GDP from not having to fund the elections this year, we have made a number of savings in other areas. In light of their potential second-round inflationary impact, we have contained the nominal increase in public sector wages, and the overall wage bill will decline by more than ½ percentage points of GDP. Domestic interest payments at 4.6 percent of GDP will remain high due to elevated rates associated with the disinflation effort but, with sharply reduced recourse to new domestic financing, this will still represent a decline of almost 1½ percentage points of GDP. Subsidies and other current transfers will continue to absorb a large share of current outlays to safeguard social spending, particularly the Farm Input Subsidy Program (FISP) and a new program for assisting our poorest citizens with housing construction, both of which we feel have sufficiently strong social and productive impact to justify their cost. Fortunately, falling world prices for fertilizers have allowed us to budget for both these programs within the share of GDP expended on the FISP alone last year. On the development side, we will increase capital spending by a 3.2 percentage points to 9.6 percent of GDP.

- On the financing side, domestic borrowing will be sharply reduced, from almost 6 percent of GDP in FY2013/14 to about 2 percent this fiscal year. As a result, and because one of the effects of high inflation is to include in the interest bill an implicit repayment of real principal, net domestic debt stock (excluding the stock of domestic arrears) will fall from 22.2 percent of GDP in 2013 to 19.4 percent in 2014, a substantial reduction. Foreign assistance will be mainly limited to project loans and funds disbursed under the Sector-Wide Assistance Programs.

23. With IMF assistance we have finalized a methodology to regularize the large stock of domestic arrears accumulated from past years. We view this as necessary to restoring private sector confidence in government policies, but remain constrained by the size of the outstanding stock relative to our available resources. All arrears will be verified and audited. Of the arrears that accumulated in FY13/14 we have made arrangements in our fiscal program for cash payments of MK 10 billion in FY14/15. Remaining arrears accumulated in FY13/14 and those incurred before will be regularized through securitization in three equal tranches during the current fiscal year and in FY15/16 and FY16/17 budgets. We will deploy auditors in each ministry, strengthen commitment controls, and hold controlling officers accountable under the PFM Act for willful breach of voted allocations in order to prevent the emergence of new unauthorized payment obligations.

Monetary and Financial Sector Policies

24. Following a year where price increases have remained at unacceptably high levels, we are determined to use monetary policy to place inflation on a clear declining trajectory. To this end, we will ensure that the central bank rate remains well above the rate of inflation, and will use liquidity operations in the interbank and Treasury bill markets to ensure the attainment and maintenance of sharply positive real interest rates in our financial system. We will also improve communication with the commercial banks and other market participants so that they are aware of our commitment to regaining price stability. We anticipate that a steadfast adherence to these policies will gradually increase the transparency and credibility of monetary policy. This credibility will be enhanced by additional amendments to the RBM Act that we submitted to Parliament as a prior action for completion of the reviews. These amendments will visibly limit the possibilities for fiscal dominance by establishing an upper bound on total government borrowing—regardless of instrument—from the RBM in any given year. Supported by this assurance, and by demonstrated fiscal discipline and ongoing improvements in our PFM systems, we anticipate that the private sector will regain confidence that our policy framework and execution is effective and sustainable, with the result that lower inflationary expectations will begin to firm up. As this

happens, and as attractive real returns on domestic assets are maintained, confidence in the kwacha is expected to increase, eventually mitigating the depreciation pressure on the domestic currency that is currently a major source of inflationary risk. Underpinning these policies will be a continued adherence to the flexible exchange rate regime, which we see as a fundamental precondition for the success of our economic adjustment policies.

25. We will combine tight monetary conditions with efforts to safeguard financial sector stability. We migrated to Basel II in early 2014, notably by raising Tier 1 and total capital requirement ratios to 10 percent and 15 percent from 6 percent and 10 percent, respectively. All banks, except two now have higher capital adequacy ratios than required under the new standard. With Fund TA, we have improved prudential norms in the areas of asset classification and provisioning. In addition, we have adopted a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action against distressed banks.

26. Third party diagnostic assessments were designed as a tool to identify problem banks as well as banking sector-wide issues. The diagnostic assessments of all banks have now been completed and reviewed. All major areas of concern have been communicated by the RBM to the boards of directors of the respective banks for their action. Reviews of measures taken by each bank to address these concerns will be conducted by the RBM through its regular on-site and off-site supervision activities. Further, in light of the findings of the assessments, the RBM will identify and design an appropriate strategy within the legal framework to address sector-wide issues.

27. Meanwhile, the restructuring process of the two weakest banks is underway and will be completed as soon as possible. A transaction advisor has completed the due diligence on one the banks and has submitted a report on possible restructuring options that encompass its sale or recapitalization. The next steps are to dispatch the Information Memorandum on the bank to all bidders and to select the preferred bidders.

28. The RBM is committed to taking further appropriate steps to address any risks in the financial sector. Efforts to strengthen the supervisory framework of the banking system are underway. This includes enhancement of both on-site and off-site supervision, as well as close monitoring and enforcement of compliance with all prudential norms. Furthermore, an external bank supervision advisor has been hired and commenced work in July 2014, focusing among other things, on enhancement of supervisory skills in the staff of RBM.

29. Loan concentration remains one of the major risk factors in our banking system. This risk has continued to rise from extension of large credit to a limited numbers of borrowers or to specific economic sectors and activities and could lead to challenges in liquidity and capital positions of banks, particularly in the wake of increasing levels of non-performing loans. The RBM will continue to closely monitor loan concentrations in the banking sector and will strictly limit waivers for specific exposures exceeding the loan concentration limit.

30. We also remain committed to strengthening the regulatory framework of the banking system. To this end, amendments to the Banking Act of 2010 and Financial Services Act of 2010 have been submitted to Parliament for enactment (prior action). These two amendments, which were informed by IMF technical assistance recommendations, will align the legal framework for

bank resolution more closely with best practices and provide more options for dealing with problem banks.

Anti-Money Laundering Initiatives

31. In light of the findings of the forensic report that the Cashgate scheme was not an opportunistic theft but rather a complex system of fraud and money laundering, we will address gaps in our regulatory framework. These measures will include amending the Anti-Money Laundering/Controlling the Financing of Terrorism (AML/CFT) Act, the Penal Code and the Corrupt Practices Act, and aligning them with the Financial Action Task Force standards and the United Nations Convention Against Corruption. The Reserve Bank of Malawi will re-evaluate its capacity to monitor and supervise possible breaches of compliance with AML requirements by banks and apply appropriate supervisory sanctions with regard to any breaches of compliance.

Public Financial Management Reform

32. The Government continues to implement the Public Finance and Economic Management Reform Programme (PFEM RP). However, in light of the weaknesses that have been highlighted in the area of Public Finance Management (PFM), Government with technical assistance from the IMF has revised the process of revising the strategy for strengthening PFM systems. It should be noted that the strategy being developed falls within the overall PFEM RP, and that it specifically recommends addressing issues regarding fiscal reporting, bank reconciliation, enforcement of commitment control, improvement of other internal controls and strengthening the overall PFM control environment. In formulating the programme, it has recognised that most PFM rules and regulations of the GoM already follow well establish standards, but their enforcement and compliance remained major challenges. For this reason, the PFM Reform Programme will ensure that the established rules and regulations are followed by adopting a "getting the basics right first" approach. Furthermore, the revised PFM Reform Programme seeks to ensure efficient and effective resource utilization within the public sector, hence maximisation of value for money in public expenditure. Therefore, the programme will seek to bring key officers in all GoM ministries, departments and agencies (MDAs) to know and understand the public finance rules and regulations, and ensure that these are practiced. The Ministry of Finance, Economic Planning and Development will establish the means of identifying where fiscal infractions occur, and of correcting such infractions as quickly and effectively as possible. In this regard, the Ministry of Finance will enhance its capacity to report and deal with laxities in financial management within all MDAs.

33. Government of Malawi implemented EPICOR (version 7.5.5) based IFMIS, to serve the Government in managing public resources efficiently, effectively and transparently.
Several operational and system deficiencies have been observed for a number of years and government has been commissioning a number of studies. These studies have revealed a number of weaknesses that have required urgent attention. We have conducted a comprehensive Business Processes Review and Reengineering (BPR) of the EPICOR based Integrated Financial Management Information System (IFMIS). The review revealed the weaknesses in the system with regards to: inadequacy of the security features, over customization of the system, limited staff manpower that affects segregation of duties, poorly defined and designed process interfaces, among others. Following the review, Government

defined the functional requirements and specifications that will in turn ensure installation of a credible system that addresses the identified shortfalls. This included specifying for a system with robust security and control features, allowance for interfaces with other Government system for seamless flow of information.

34. Government has decided to procure a new system of IFMIS instead of upgrading the current version 7.5.5 to version 10. Government has identified five best and well known IFMIS systems in the world and plans to assess them in order to identify the most suitable one for Government business in Malawi. The EPICOR version 10 will be amongst the systems to be assessed. We have established IFMIS Steering and Technical Committees with clear terms of reference (ToRs) to oversee the procurement and implementation of the new IFMIS.
These committees have already developed an implementation plan for the new system but also a plan for ensuring that the current system is secure and well functioning without disrupting Government business in accounting functions. While enhancements to the current system are already underway, Government has also finalised development of the bidding documents for the new system and procurement processes are expected to commence in January 2014. We believe with proper planning and technical expertise the new system will be up and running in July 2016. This will ensure that time lines are not being missed and milestones are being met as planned.

35. In order to strengthen the scrutiny and audit functions, we have moved the Central Internal Audit Unit to the Ministry of Finance, Economic Planning and Development from the Office of the President and Cabinet in order to revamp the internal audit functions. In recent times, the Government has recruited more internal auditors specialised in various fields other than accounting background alone to ensure that there is diversity in terms of areas of focus. We have engaged Cowater International of Canada to enhance capacity and skills in various types of audits especially in risk based internal audit. Cowater is also providing training in IT Audit.

36. We also plan to place an internal auditor in every MDA so as to detect fiscal infractions early enough for correction. The internal auditors will report to the Ministry of Finance. We are also in the process of engaging private internal auditors to help in transfer of skills to our internal auditors. In addition, we have engaged an experienced advisor in the Ministry of Finance, who will follow up on possible fiscal malpractices as reported by the internal auditors. The advisor will also assist the Ministry of Finance in strengthening the PFM framework.

37. In order to address the cash flow management, we have revitalised the cash management committee meetings and MDAs are being restricted to spend within their approved budgets, and requests for extra-budgetary funding is not being allowed. The Ministry of Finance plans to submit monthly expenditure reports to all MDAs. These will indicate monthly and cumulative expenditure figures as well as available balances on their allocations. This will allow MDAs to plan and limit their expenditures to the allocations. We have strengthened budget monitoring by re-orienting our Budget/desk officers to monitor budget performance better, and are required to submit monthly budget performance reports. This procedure involves the tracking of the accumulation of arrears by MDAs.

38. More importantly, we plan to enforce the legal mandates of the Minister and Secretary to the Treasury in applying sanctions as the requirements of the PFM legal and regulatory

frameworks, including applying sanctions to institutions and individuals that fail to comply with those requirements.

39. To this end, we have developed a PFM strategy to operationalize our agenda and put in place institutional structures to monitor and control our progress. This action plan includes the key recommendations of the FAD technical assistance mission on PFM of which the transfer of revenues to the government's main account will facilitate the reconciliation of government accounts (prior action) as well as elements from the forensic audit report.

The closure of redundant and dormant accounts, the preparation of reports on the stock of arrears, and the audit by an international firm of the status of implementation are key benchmarks.

Program Issues and Monitoring

40. For the fifth review (end-December 2013 test date) the periodic performance criterion (PC) on net domestic assets (NDA)and the indicative target (IT) on reserve money and social spending were not met, in part because of the shortfalls in external financing. For the sixth review, the periodic PC on NDA, net domestic financing (NDF),and the IT on reserve money and social spending were not met owing in part to continued difficulties in program implementation in the face of continued shortfalls in external financing and election uncertainties. For the fifth and sixth reviews, the continuous PC on the contracting of nonconcessional external debt with a maturity of more than one year was not met due to the contracting of the above-mentioned non-concessional loans. The RBM intensified its open market operations to ensure that the September 2014 informal targets on NDA and gross reserves agreed with the staff were met but that on NDF was missed. The RBM will continue to mop up liquidity through over issuance of Treasury bills and maintain a tight stance of monetary policy. Additional informal targets on gross reserves, NDA and NDF were set for end-January 2015 to anchor monetary and fiscal policies. Gross international reserves and NDA were met but NDF was missed due to shortfalls in donor dedicated grants for social sectors. On the basis of these corrective actions we have put in place, we request for a waiver for the nonobservance of the performance criterion for the fifth review on NDA. We also request for a waiver for the nonobservance of the performance criteria for the sixth reviews on NDA, net domestic financing (NDF). For the fifth and sixth reviews, we request waivers for the nonobservance of the performance criteria on nonconcessional external debt maturing in more than one year and on the accumulation of external payments arrears.

41. Program implementation will continue to be monitored with quantitative targets and structural benchmarks (TMU Tables 3 and 6). PCs have been established for June 2015 and December 2015. The seventh review is expected to be completed by mid-September 2015 based on the end-June 2015 test date and the sixth review is expected to be completed by mid-April 2016 based on the end-December 2015 test date.

Attachment II. Technical Memorandum of Understanding

March 2015

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

COVERAGE

2. **The central government includes all units of government that exercise authority over the entire economic territory.** Unless otherwise indicated, the central government does not include local governments, the Reserve Bank of Malawi (RBM), or any other public entity with autonomous legal personality. The accounts of the monetary authorities include those of the Reserve Bank of Malawi (RBM). Monetary aggregates under the program are based on the twelve-bank monetary survey.

QUANTITATIVE PERFORMANCE CRITERIA: DEFINITIONS AND DATA SOURCES

A. Budget Support

3. **Definition of budget support:** Budget support includes all grants and foreign financing not directly linked to additional budgetary expenditure. Excluded from this definition is external project financing to fund particular activities, including food security funding from the European Union; loan financing from the IMF; and donor inflows from the U.S. dollar–denominated donor pool accounts for the health SWAp, education SWAp, agricultural SWAps, and National AIDS Commission (NAC) held in the Malawi banking system. Budget support is measured as a cumulative flow from the beginning of the fiscal year. It will be recorded in the original currency of disbursement and then converted into U.S. dollars using the program cross exchange rates listed in Table 6.

B. Floor on Net International Reserves of the RBM

4. **Definition of net international reserves (NIR) of the RBM:** The NIR of the RBM is defined as gross reserve assets minus gross reserve liabilities. For evaluation purposes, the values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the program cross exchange rates for the various currencies. The program exchange rate of the Malawi Kwacha to the U.S. dollar is set at MK 402 = US$1.

5. **Gross reserve assets of the RBM** are defined in the *International Reserves and Foreign Currency Liquidity Guidelines for a Data Template* as external assets immediately available and controlled by RBM "for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency's exchange rate, and for other related purposes (such as

maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing)" (*BPM6,* paragraph 6.64).

6. **Gross reserve assets of the RBM** include the following: (i) monetary gold holdings of the RBM; (ii) holdings of SDRs; (iii) the reserve position in the IMF; (iv) foreign convertible currency holdings; (v) foreign currency denominated deposits held in foreign central banks, the Bank for International Settlements, and other banks; (vi) loans to foreign banks redeemable upon demand; (vii) foreign securities; and (viii) other unpledged convertible liquid claims on nonresidents. It excludes the following: (i) any foreign currency claims on residents; (ii) capital subscriptions in international institutions; (iii) foreign assets in nonconvertible currencies; (iv) transfers of foreign currency claims to RBM by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates; (v) assets obtained through currency swaps of less than three months duration; (vi) gross reserves that are in any way encumbered or pledged, including, but not limited to: (a) assets blocked when used as collateral for third party loans and third-party payments, or pledged to investors as a condition for investing in domestic securities; (b) assets lent by RBM to third parties that are not available before maturity, and are not marketable; and (c) foreign reserves blocked for letters of credit.

7. **Gross reserve liabilities of the RBM** are defined as the sum of the following: (i) outstanding medium and short-term liabilities of the RBM to the IMF; (ii) all short-term foreign currency liabilities of the RBM to nonresidents with an original maturity of up to, and including, one year; and (iii) all foreign currency denominated liabilities to residents (including, for instance, foreign currency denominated deposits of domestic banks and other residents with the RBM). SDR allocations are excluded from gross reserve liabilities of the RBM.

Adjusters Applied to NIR Program Ceiling

8. The program floor on NIR will be adjusted as follows if budget support, inflows from donor accounts for the social sectors, and external debt service to the World Bank and the African Development Bank (ADB) deviate from their programmed levels:

- **Budget support:** The floor on the NIR of the RBM will be adjusted upward by the full amount by which the cumulative receipts from the budget support are greater than US$10 million above the program baseline (as defined in Table A). The floor on NIR of the RBM will be adjusted downward by the amount by which the cumulative receipts from budget support are less than the program baseline. This downward adjustment of the NIR floor will be subject to the limitations outlined in paragraph 9.

Table A. Program Baseline: Projected Budget Support, March–December, 2015
(In millions of USD, cumulative within the fiscal year[1])

	Mar-15	Jun-15	Sep-15	Dec-15
Budget support	0.0	17.7	0.0	0.0

[1]Fiscal year runs from July 1 to June 30 of the following year

- **Donor pool accounts for the social sector,** including health and education SWAps, and National AIDS Commission (NAC): The floor on the NIR of the RBM will be adjusted downward by the amount by which the donor inflows from the U.S. dollar–denominated donor accounts for SWAps and NAC held in the RBM are smaller than the program baseline (as defined in Table B). This downward adjustment of the NIR floor will be subject to the limitations outlined in paragraph 9. These donor inflows are measured as the cumulative receipts by the budget from the beginning of the fiscal year. They will be recorded in the original currency of disbursement and then converted to U.S. dollars using the above defined program cross exchange rates.

Table B. Program Baseline: Projected Inflows from Donor Accounts for the Social Sector, March–December, 2015
(In millions of USD, cumulative within the fiscal year[1])

	Mar-15	Jun-15	Sep-15	Dec-15
Donor inflows	47.7	51.4	6.8	37.9

[1]Fiscal year runs from July 1 to June 30 of the following year

- **Debt service payments:** The floor on NIR of the RBM will be adjusted upward (downward) by the full cumulative amount by which debt service payments to the World Bank and the African Development Bank fall short of (exceed) the program baseline (as defined in Table C). Debt service payments will be measured as the cumulative payments from the beginning of the fiscal year. They will be recorded in the original currency of payment and then converted to U.S. dollars using the above defined program cross exchange rates. This downward adjustment of the NIR floor will be subject to the limitations outlined in paragraph 9.

Table C. Projected Debt Service Payments to World Bank and AfDB, March–December, 2015
(In millions of USD, cumulative within the fiscal year[1])

	Mar-15	Jun-15	Sep-15	Dec-15
Debt service	8.2	12.1	3.9	7.8

[1]Fiscal year runs from July 1 to June 30 of the following year

9. **Cumulative adjustment to the NIR program target:** Notwithstanding the adjustments stipulated in paragraph 8, the total downward adjustment to the NIR program target from the combined impact of a (i) a shortfall of budget support relative to the program projections; (ii) a shortfall of inflows to the donor accounts for the social sector relative to the program projections; and (iii) any excess of debt service payments to the World Bank and the African Development Bank (ADB) relative to the program projections, will be subject to a cumulative limit of US$15 million.

C. Net Foreign Assets of the RBM

10. **Definition of Net Foreign Assets (NFA) of the RBM:** The NFA of the RBM are defined as its gross foreign assets (GFA) minus its gross foreign liabilities. Gross foreign liabilities are equal to gross reserve liabilities as defined in paragraph 7, plus any other foreign liabilities not listed in that paragraph.

11. **Gross foreign assets (GFA) of the RBM** are defined as gross reserves assets as defined in paragraph 6, plus (i) any foreign currency claims on residents; (ii) capital subscriptions in international institutions; (iii) foreign assets in nonconvertible currencies; (iv) transfers of foreign currency claims to RBM by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates; (v) assets obtained through currency swaps of less than three months duration; (vi) gross reserves that are in any way encumbered or pledged, including, but not limited to: (a) assets blocked when used as collateral for third party loans and third-party payments, or pledged to investors as a condition for investing in domestic securities; (b) assets lent by RBM to third parties that are not available before maturity, and are not marketable; and (c) foreign reserves blocked for letters of credit.

D. Reserve Money of the RBM

12. **Definition of reserve money of the RBM (RM):** Reserve money is defined as the sum of currency issued by the RBM, including currency outside banks, the vault cash of commercial banks, and balances of commercial banks' accounts with the RBM. Commercial banks' accounts with the RBM include required reserves held for local currency and foreign currency deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM.

E. Ceiling on Net Domestic Assets of the RBM

13. For program proposes, net domestic assets (NDA) of the RBM are defined in kwacha terms as reserve money less NFA of the RBM at the program exchange rate.

Adjusters Applied to NDA Program Ceiling

14. The program ceiling on NDA will be adjusted as follows if budget support, inflows from donor accounts for the social sector, and external debt service to the World Bank and the African Development Bank (ADB) deviate from their programmed levels:

- **Budget support:** For the purposes of this adjustor, cumulative receipts from budget support will be measured in the foreign currency of disbursement and converted to kwacha using the program exchange rates. The ceiling on NDA of the RBM will be adjusted downward by the amount that cumulative receipts from budget support exceed the sum of the program baseline (as defined in Table D) and the kwacha equivalent of US$10 million. The kwacha equivalent of US$10 million will be calculated as US$10 million multiplied by the program exchange rate. The ceiling on NDA of the RBM will be adjusted upward by the amount that cumulative receipts from budget support (in kwacha) fall short of the program baseline, with this upward adjustment to the NDA ceiling subject to the limitations described in paragraph 15. The kwacha equivalent of the upward adjustment will be calculated as the US dollar value of the adjustment multiplied by the program exchange rate.

Table D. Program Baseline: Projected Budget Support, March–December, 2015
(In billions of kwacha, cumulative within the fiscal year[1])

	Mar-15	Jun-15	Sep-15	Dec-15
Budget support, at the program exchange rate	0.0	8.0	0.0	0.0
Budget support plus kwacha equivalent of US$10 mil, at the program exchange rate	0.0	12.2	0.0	0.0

[1]Fiscal year runs from July 1 to June 30 of the following year

- **Donor pool accounts for the social sector** (including health, education, and NAC): For the purposes of this adjustor, cumulative receipts from donor [pool] accounts for the social sector will be measured in the foreign currency of disbursement and converted to kwacha using the program exchange rates. The ceiling on NDA of the RBM will be adjusted upward by the amount by which the donor inflows to the budget (in kwacha) from the U.S. dollar–denominated donor accounts for the SWAps and NAC held in the RBM fall short of the donor inflow to those accounts in the program baseline (as defined in Table E). This upward adjustment to the NDA ceiling will be subject to the limitations described in paragraph 15. The kwacha equivalent of the upward adjustment will be calculated as the US dollar value of the adjustment multiplied by the program exchange rate.

Table E. Program Baseline: Projected Inflows from Donor Accounts, March–December, 2015
(In billions of kwacha, cumulative within the fiscal year[1])

	Mar-15	Jun-15	Sep-15	Dec-15
Donor inflows, at the program exchange rate	20.0	21.6	2.9	15.9

[1]Fiscal year runs from July 1 to June 30 of the following year

- **Debt service payments:** For the purposes of this adjustor, cumulative debt service payments (from the beginning of the fiscal year) will be measured in the foreign currency of payment and converted to kwacha using the program exchange rates. The ceiling on NDA of the RBM will be adjusted downward (upward) by the full cumulative amount by which debt service payments to the World Bank and the ADB falls short of (exceeds) the program baseline (as defined in Table F). The upward adjustment to the NDA ceiling will be subject to the limitations described in paragraph 15.

Table F. Program Baseline: Projected Debt Service Payments, March–December, 2015
(In billions of kwacha, cumulative within the fiscal year[1])

	Mar-15	Jun-15	Sep-15	Dec-15
Debt service, at the program exchange rate	3.3	4.9	1.7	3.1

[1]Fiscal year runs from July 1 to June 30 of the following year

- **Additional adjustment for changes in the liquidity reserve requirement:** The ceiling on NDA of the RBM will be adjusted downward for a decrease in the reserve requirement ratio on domestic deposits, and will be adjusted upward for an increase in the ratio. The adjustment will be spread equally over two quarters, starting in the quarter in which the reserve requirement ratio is reduced. The adjuster will be calculated as follows: (one minus the existing required fraction of reserve assets) multiplied by (the program baseline required reserve ratio minus the new required reserve ratio) multiplied by (the amount of average reservable deposit liabilities in commercial banks during the last month before the change in regulation). The program baseline required reserve ratio was 15.5 percent at end-June 2014.

15. **Cumulative adjustment to the NDA program target:** Notwithstanding the adjustments outlined above in paragraph 14, the total upward adjustment to NDA from the impact of (i) a shortfall of budget support relative to the program assumptions; (ii) a shortfall of inflows to

the donor accounts for the social sector relative to the program assumptions; and (iii) an excess of debt service payments to the World Bank and the African Development Bank relative to the program assumptions will be capped at the kwacha equivalent of US$15 million. The kwacha equivalent of US$15 million will be calculated as US$15 million multiplied by the program exchange rate. The adjustment to the NDA ceiling for changes in the liquidity reserve requirement is independent of the other adjustments and is not subject to limitation.

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

16. **Definition of central government net domestic borrowing (CGDB):** CGDB is defined as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, government bonds, and holdings of treasury bills and treasury notes minus deposits); plus (ii) net borrowing from commercial banks (including advances, holdings of local registered stocks, and holdings of treasury bills and treasury notes minus deposits); plus (iii) net borrowing from nonbanks (including, but not limited to, holdings of local registered stocks and holdings of treasury bills and treasury notes); plus (iv) holdings of promissory notes. Excluded from the CGDB ceiling are (i) promissory notes issued to cover exchange rate valuation losses of RBM; and (ii) government securities issued in 2014 and 2015 to clear government domestic arrears up to a maximum exclusion of MKW 157 billion. Treasury bills and locally registered stocks will be valued at cost rather than face value. The ceiling is measured as the change in the stock of CGDB cumulative from the beginning of the fiscal year, including promissory notes and securities transferred to the RBM from the treasury since the beginning of the fiscal year. Transfers from extra-budgetary funds will not be considered revenues for this performance criterion. Instead, they will be treated as domestic borrowing from the private sector (as their accounts are outside the definition of government). Asset sales or privatization revenues will be accounted for under financing as a separate category, separate from domestic or foreign financing in calculating CGDB.

Adjusters Applied to CGDB Program Ceiling

17. The program ceiling on CGDB will be adjusted as follows if budget support, inflows from donor accounts for the social sector, and external debt service to the World Bank and the African Development Bank deviate from their programmed levels.

18. The program ceiling on CGDB will be adjusted as follows if budget support, inflows from donor accounts for the social sector, and external debt service to the World Bank and the African Development Bank deviate from their programmed levels.

- **Budget support:** For the purposes of this adjustor, cumulative receipts from budget support will be measured in the foreign currency of disbursement and converted to kwacha using the program exchange rates. The program ceiling on CGDB will be adjusted upward by the full amount by which cumulative receipts from budget support are less than the program baseline (as defined in Table D). This upward adjustment to CGDB will be subject to the limitations described in paragraph 20. In the event of excess budget support, the ceiling on CGDB will be adjusted downward by the amount that cumulative receipts from budget support exceed the sum of the program baseline (as defined in Table D) and the kwacha equivalent of US$10 million. The kwacha equivalent of US$10 million will be calculated as US$10 million multiplied by the program exchange rate.

- **Donor pool accounts for the social sector,** including health and education SWAps, and NAC: For the purposes of this adjustor, cumulative receipts from donor pool accounts for the social sector will be measured in the foreign currency of disbursement and converted to kwacha using the program exchange rates. The ceiling on CGDB will be adjusted upward by the amount by which donor inflows to the budget from the U.S. dollar–denominated donor accounts for health, education, and other SWAps, and NAC held in RBM fall short of the program baseline (as defined in Table E). This upward adjustment to CGDB will subject to the limitations described in paragraph 19.

- **Debt service payments:** For the purposes of this adjustor, cumulative debt service payments (from the beginning of the fiscal year) will be measured in the foreign currency of payment and converted to kwacha using the program exchange rates. The ceiling (floor) on CGDB will be adjusted downward (upward) by the full cumulative amount by which debt service payments to the World Bank and the ADB fall short of (exceed) the program baseline (as defined in Table F). This upward adjustment to CGDB will subject to the limitations described in paragraph 20.

19. **Cumulative adjustment to the CGDB program target:** The total upward adjustment to CGDB from a shortfall of (i) budget support relative to the program baseline, (ii) donor inflows to the donor accounts for the social sector relative to the program baseline and (iii) an excess of actual debt service payments to the World Bank and the African Development Bank (ADB) relative to the program baseline will be capped at US$15 million. The kwacha equivalent of US$15 million will be calculated as US$15 million multiplied by the program exchange rate.

G. Ceiling on External Payment Arrears

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

H. Ceiling on Non-concessional External Debt

21. **Definition of non-concessional external debt:** The definition of debt, for program purposes, is set out in Executive Board Decisions No. 6230–(79/140) August 3, 1979, and as amended by Decisions No. 11096–(95/100), October 25, 1995; 12274–(00/85) August 24, 2000;

and 14416–(09/91), August 31, 2009. For program purposes, short-, medium- and long-term debt is non-concessional if it includes a grant element of less than 35 percent, as indicated in Decision No. 11248–(96/38), April 15, 1996. The grant element is calculated using a discount rate of 5 percent. The ceiling on non-concessional debt applies to the contracting and guaranteeing of debt with nonresidents by the central government, the RBM, public enterprises, and other official sector entities, unless an explicit selective exclusion is made per paragraph 24.
This performance criterion is monitored on a continuous basis. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from the beginning of the fiscal year.

22. **Definition of short-term debt:** Short-term debt is outstanding stock of debt with an original maturity of one year or less.

23. **Definition of medium- and long-term debt:** Medium- and long-term debt is outstanding stock of debt with a maturity of more than one year.

24. **Excluded from the limit on non-concessional external debt is the following:** (i) the use of IMF resources; (ii) any kwacha-denominated treasury bill and local registered stock holdings by nonresidents purchased from the secondary market; (iii) debts classified as international reserve liabilities of the RBM; (iv) new debt issued to restructure, refinance, or repay existing non concessional external debt as of December 31, 2014, up to the amount actually used for the above-mentioned purposes; (v) normal import financing; and (iv) arrangements to pay overtime obligations arising from judicial awards to external creditors—a financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

QUANTITATIVE INDICATIVE TARGETS AND STRUCTURAL BENCHMARKS

25. **Reserve money of the RBM:** Reserve money of the RBM is defined in paragraph 12 above. The program baseline for reserve money is defined in Table G. No adjusters are applicable to reserve money targets for program purposes.

Table G. Projected Stock of Reserve Money, March–December, 2015
(In billions of kwacha, cumulative within the fiscal year[1])

	Mar-15	Jun-15	Sep-15	Dec-15
Reserve money	223.4	243.8	248.2	260.5

[1]Fiscal year runs from July 1 to June 30 of the following year

26. **Social spending:** Using functional classification of expenditure, social spending is defined as the sum of central government spending on health, education, the farm input subsidy program, the cement and iron sheet program, and government social protection (comprising

government expenditures by the Ministry of Gender, Children, and Social Welfare, the Ministry of Disability and Elderly Affairs, the local development fund, and the Poverty and Disaster Management Cost Center under the Office of the Vice President. In order to maintain Malawi's commitment and progress toward poverty reduction and the MDGs, the social spending allocations in the government budget will not subject to downward adjusters under the program. Quarterly social spending under this definition is presented in Table 8.

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

28. **Structural benchmarks** are contained in Tables 5 and 6.

Table 1. Malawi: Quantitative Targets, 2013[1]

	Target type [2]	End-June 2013 (IT)				End-September 2013 (PC)				End-December 2013 (PC)			
		Prog.[10]	Adj. Prog.[10]	Actual	Status	Prog.[10]	Adj. Prog.[10]	Actual	Status	Prog.[10]	Adj. Prog.[10]	Actual	Status
I. Monetary targets (millions of kwacha)													
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	108,487	110,839	72,920	M	87,854	59,365	81,224	NM	107,710	110,715	120,781	NM
2. Ceiling on reserve money[3]	IT	106,902	106,902	126,570	NM	110,017	110,017	134,756	NM	135,223	135,223	156,899	NM
II. Fiscal targets (millions of kwacha)													
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	-18,605	-16,253	-2,492	NM	-5,218	-2,018	58,685	NM	72,042	75,047	73,683	M
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	185,511	185,511	181,764	NM	15,330	15,330	48,952	M	106,617	106,617	105,007	NM
III. External sector targets (US$ millions, unless otherwise indicated)													
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	53	46	270	M	127	117	254	M	188	177	215	M
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	0		0	0	0	M	0	0	2.2	NM
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0	0	142	NM	0	0	0	M	0	0	145.3	NM
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0		0	0	0	M	0	0	0	M
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9,10]	PC				M				M				M
Memorandum items:													
Net foreign assets of the RBM (US$ millions)		-5		151		69		167		86		113	
Budget support (US$ millions)		245		244		50		9		27		19	
Budget support (millions of kwacha)		78,355		78,219		15,978		2,846		8,645		6,080	
Debt service payments to the World Bank and AfDB (US$ millions)		6		6		1		1		5		4	
Debt service payments to the World Bank and AfDB (millions of kwacha)		1,920		1,936		465		465		1,475		1280	
Health SWAp receipts (millions of kwacha)		11,290		15,040		3,194		4,815		6,971		3,711	
Education SWAp receipts (millions of kwacha)		23,245		1,764		4,800		3,548		9,191		13,532	
NAC receipts (millions of kwacha)		12,281		441		4,288		999		3,070		0	
Program exchange rate (kwacha per US$)		320		320		320		320		320		320	

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

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

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

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

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

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

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

[7] Defined as a cumulative flow from the biginning of the fiscal year.

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

[9] Evaluated on a continuous basis.

[10] IMF Country Report No. 14/37

Table 2. Malawi: Quantitative Targets, 2014[1]

	Target type [2]	End-Mar. 2014 (IT)				End-June 2014				End-Sep. 2014 (IT)			
		Prog.[10]	Adj. Prog.	Act.	status	Prog.[10]	Adj Prog.	Act.	status	Prog.[10]	Adj Prog.	Act.	status
I. Monetary targets (millions of kwacha)													
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	113,035	115,595	117,434	NM	94,817	97,697	142,547	NM	97,701	97,701	136,885	NM
2. Ceiling on reserve money[3]	IT	134,392	134,392	169,100	NM	145,225	145,225	193,201	NM	151,232	151,232	192,097	NM
II. Fiscal targets (millions of kwacha)													
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	52,018	54,578	81,548	NM	6,622	9,502	93,147	NM	-20,023	-18,423	19,521	NM
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	170,424	170,424	167,106	NM	214,832	214,832	206,961	NM	...			
III. External sector targets (US$ millions, unless otherwise indicated)													
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	169	161	262	M	260	251	259	M	269	265	475	M
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	4.2	NM	0	0	9.2	NM	0	0	14	NM
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0	0	145.3	NM	0	0	149.3	NM	0	0	149.3	NM
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0	M	0	0	0	M	0	0	0	M
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9]	PC								M				M
Memorandum items:													
Net foreign assets of the RBM (US$ millions)		67		161		158		158		167		173	
Budget support (US$ millions)		111		35		167		67		209		67	
Budget support (millions of kwacha)		35,445		11,130		53,509		21,361		66,878		21,361	
Debt service payments to the World Bank andAfDB (US$ millions)		6		4		7		6		2		2	
Debt service payments to the World Bank and AfDB (millions of kwacha)		1,777		1,376		2,306		1,920		529		529	
Health SWAp receipts (millions of kwacha)		7,234		-4,968		8,834		-4,968		2,433		1,941	
Education SWAp receipts (millions of kwacha)		13,600		14,466		15,567		14,466		2,829		994	
NAC receipts (millions of kwacha)		3,070		1,859		4,030		3,476		971		0	
Program exchange rate (kwacha per US$)		320		320		320		320		320		320	

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

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

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

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

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

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

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

[7] Defined as a cumulative flow from the beginning of the fiscal year.

[8] Priority social spending as defined in the TMU and quantified in the authorities'

[9] Evaluated on a continuous basis.

[10] IMF Country Report No. 14/37

Table 3. Malawi: Quantitative Targets, 2015[1]

	Target type [2]	End-March 2015 (IT)		End-June 2015		End-Sept 2015 (IT)		End-Dec 2015	
		Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.
I. Monetary targets (millions of kwacha)									
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	71,574		87,033		73,959		83,792	
2. Ceiling on reserve money[3]	IT	223,402		243,828		248,213		260,545	
II. Fiscal targets (millions of kwacha)									
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	59,083		37,030		40,407		58,162	
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	205,055		257,430		54,725		146,687	
III. External sector targets (US$ millions, unless otherwise indicated)									
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	475		487		531		537	
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0		0		0		0	
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0		0		0		0	
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0		0		0		0	
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9]	PC								
Memorandum items:									
Net foreign assets of the RBM (US$ millions)		378		390		433		440	
Budget support (US$ millions)		0		18		0		7	
Budget support (millions of kwacha)		0		8000		0		3224	
Debt service payments to the World Bank andAfDB (US$ millions)		8.22		12.12		3.90		7.80	
Debt service payments to the World Bank and AfDB (millions of kwacha)		3,304		4,872		1,568		3,136	
Health SWAp receipts (millions of kwacha)		15,668		15,668		2,114		14,993	
Education SWAp receipts (millions of kwacha)		1,743		3,384		0		0	
NAC receipts (millions of kwacha)		0		0		164		332	
Program exchange rate (kwacha per US$)		402		402		402		402	

Sources: IMF staff projections.

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

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

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

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

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

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

7 Defined as a cumulative flow, starting from the beginning of the fiscal year.

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

9 Evaluated on a continuous basis.

Table 4. Malawi: Informal Quantitative Targets

	End-Sept 2014			End-Dec 2014			End-January 2015		
	Informal Targets	Actual	Status	Proj.	Actual	Status	Informal targets	Actual	Status
Ceiling on net domestic assets of the RBM (millions of kwacha)[1]	132,004	121,696	Met	84,632	66,329	Met	94,632	11,918	Met
Ceiling on central government's net domestic borrowing (millions of kwacha)[2]	8,527	19,521	Not Met	44,000	36,172	Met	46,000	58,068	Not Met
Floor on gross official reserves (US$ millions)[3]	450	457	Met	515	586	Met	500	631	Met

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

[1]NDA as reported by the RBM.

[2]Defined as a cumulative flow from the beginning of the fiscal year.

[3]Gross official reserves equal gross reserves assets as defined in the TMU.

Table 5. Malawi: Prior Actions

Measure	Target date	Macro Rationale	Status
Prior Action			
Fiscal policy			
Implement expenditure cuts necessary to limit net domestic financing under the program ceiling for the fiscal year 2014/15 and issue a memo to cabinet outlining new expenditure ceilings.	End-February 2015	To ensure consistency between the budget and the program.	Met
Public financial management			
Ministry of Finance to issue a letter to the central bank to transfer revenues to main government account (MG1)	End-February 2015	First step towards better cash management and reconciliation of accounts.	Met
Incorporate the main government bank accounts in IFMIS, including MG1 account and the six operational accounts, namely (i) salaries, (ii) other recurrent transactions, (iii) development, (iv) statutory, (v) advances, and (vi) deposits.	End-February 2015	Integrate key accounts into IFMIS progressively to ensure an improved accounting, cash management and reconciliation of accounts.	Met
Monetary policy			
Submit to parliament legislative amendments to limit RBM's credit to government to a 10 percent of the previous year's revenue.	End-February 2015	Reduce fiscal dominance to enhance effectiveness of monetary policy.	Met
Financial sector			
Submit to parliament amendments to the Banking Act and Financial Services Act in line with those recommended by March 2013 Fund (LEG) TA mission.	End-February 2015	Promote financial stability by enhancing RBM's bank resolution powers and tools.	Met

Sources: IMF staff and Malawian authorities

Table 6. Malawi: Structural Benchmarks, 2015

Measures	Target date	Macro Rationale
Public financial management		
Publish detailed monthly budget execution data by vote on the Ministry of Finance's website no later than 6-weeks after execution.	End-March 2015	To foster greater fiscal transparency and monitoring.
Reconcile all government bank accounts MG1 and six operational accounts and ways and means for all 2014 transactions signed by the Accountant General and Secretary of the Treasury.	End-March 2015	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.
Review all bank accounts and close redundant and dormant accounts and provide an updated list from the central bank certified by the Accountant General.	End-March 2015	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.
Prepare a report on the flow and stock of arrears at the end of each quarter starting with with end-September 2014 and within two months of the end of each six months.	End-June 2015	To monitor emergence of arrears.
Produce and publish monthly summary bank account control reports.	End-September 2015	To improve transparency and control.
Issue reports by international audit firms on bank reconciliations and summary bank account control reports.	End-September 2015	To improve transparency and restore public confidence.
Issue a report by an International firm confirming the status of implementation of forensic audit recommendations in the PFM domain.	End-December 2015	Foster greater transparency.
Financial sector		
Prepare a strategy to address banking sector wide issues raised by the third-party diagnostics assessments, including the high loan concentration among banks.	End-March 2015	To safeguard the stability of the financial system.
RBM to obtain from all undercapitalized banks to submit detailed, quarterly monitorable recapitalization and restructuring plans showing how they will reach the minimum capital adequacy level within one year.	End-April 2015	To safeguard the stability of the financial system.
RBM to obtain from all banks with significant deficiencies (e.g.: on loan documentation) reported by the diagnostic assessments to submit plans to address the deficiencies within one year.	End-June 2015	To safeguard the stability of the financial system.
RBM to develop contingency plans to intervene and resolve banks if they do not submit or comply with acceptable recapitalization plans.	End-June 2015	To safeguard the stability of the financial system.
Submit to parliament amendments to the AML/CFT Act, the Penal Code, and the Corrupt Practices Act in line with the FATF standard and the United Nations Convention against Corruption (UNCAC).	End-June 2015	To ensure that: (i) enhanced customer due diligence is required with regard to domestic politically exposed persons ; (ii) suspicious transactions are reported when there is a suspicion that funds are the proceeds of a criminal activity ; (iii) there is adequate transparency of legal persons and arrangements; (iv) acts of corruption are adequately criminalized and constitute predicate crimes to money laundering; (v) self-self-laundering is criminalized, and (vi) there are appropriate administrative sanctions for failure to comply with AML/CFT requirements.
RBM issue a detailed report on compliance with regulations on loan classification and provisioning and concentration limits in line with existing directives.	End-September 2015	To safeguard the stability of the financial system.
RBM, in its supervisory capacity, to follow-up on possible breaches of compliance with the AML legal framework by banks revealed by the audit report, by applying supervisory actions mandated by the AML legal framework with regard to any breaches of compliance, including sanctions.	End-December 2015	To ensure compliance with AML standards.

Sources: IMF staff and Malawian authorities

Table 7. Malawi: Cross Rates for Nominal Exchanges Rates and Gold Price for Program

	September 2014
Gold bullion LBM[1] US$/troy ounce	1,236.55
SDR to US$ exchange rate	0.667
Euro to US$ exchange rate	0.775
Yen to US$ exchange rate	107.244
Yuan to US$ exchange rate	6.153
Rand to US$ exchange rate	10.978
UK £ to US$ exchange rate	0.614

Source: IMF (International Financial Statistics)

[1] LBM connotes London Bullion Market

Table 8. Malawi: Social Spending: FY2013/14
Millions of Kwacha

Category	Q1 Actual	Q2 Proj.	Q3 Proj.	Q4 Proj.	Total Proj.
Health Expenditure	**15,321**	**18,822**	**17,782**	**17,223**	**69,146**
Wages	9,280	7,259	7,259	7,259	31,058
Other Recurrent	5,756	9,537	8,497	8,197	31,988
Ministry of Health ORT	2,797	4,785	3,791	3,791	15,165
Local Assemblies ORT	2,893	4,518	4,556	4,256	16,222
Subvented Organisations	66	234	150	150	601
Development expenditure	284	2,025	2,025	1,766	6,100
Education Expenditure	**30,353**	**30,738**	**30,929**	**29,973**	**121,993**
Wages	16,933	14,470	14,470	14,470	60,343
Other Recurrent	13,089	14,858	13,974	13,972	55,891
Ministry of Education ORT	3,378	4,014	3,696	3,696	14,784
Local Assemblies ORT	1,852	2,265	2,059	2,057	8,232
Subvented Organisations	7,859	8,579	8,219	8,219	32,876
Development expenditure	331	1,411	2,486	1,532	5,758
Farm Input Subsidy Program	**5,487**	**31,777**	**13,222**	**0**	**50,485**
Cement and Iron Sheets Subsidy	**0**	**3,000**	**1,000**	**3,000**	**7,000**
Gender, Children, Disability and Social	**436**	**629**	**516**	**514**	**2,095**
Wages	257	231	231	231	949
Other Recurrent	157	250	203	203	814
Development expenditure	22	148	82	80	332
Total Gender, Children, Disability and Social	**436**	**629**	**516**	**514**	**2,095**
Local Development Fund	**178**	**2,072**	**1,125**	**1,125**	4,500
Poverty and Disaster Management Cost	**37**	**25**	**26**	**26**	**114**
Wages	20	9.7	9.7	10	49
Other Recurrent	17	15	16	16	65
Total Social Expenditure	**52,247**	**87,692**	**65,116**	**52,375**	**257,429**

Source: Malawian authorities

Table 9. Malawi: Reporting Requirements

Data Description	Data Freq.	Reporting Agency	Reporting Freq.	Delivery Lag	Delivery Date	Delivery Mode
Gross international reserves, exchange rate, and foreign exchange purchases and sales	D	RBM	W	2	F	E
Reserve money and its components (NDA and NFA), OMO transactions, and RBM conversion of treasury bills; RBM balance sheet	W	RBM	M	30	30	E
Daily exchange rate	D	RBM	W	1	F	E
Treasury bill auction results	W	RBM	W	2	F	E
Spread between bureau midrate and the official exchange midrate	W	RBM	M	30	30	E
Spread between commercial bank midrate and the official exchange midrate	W	RBM	M	30	30	E
International Reserve and Foreign Currency Liquidity Data Template	M	RBM	M	30	30	E
NIR and its components	W	RBM	W	7	F	E
Central government domestic borrowing	M	RBM	M	30	30	E
Interest rates	M	RBM	M	30	30	E
Holdings of local registered stocks and treasury bills	M	RBM	M	30	30	E
Detailed issue and maturity profile for treasury bills	M	RBM	M	30	30	E
Excess reserves by bank	W	RBM	M	30	30	E
Details of project and balance of payment support	M	RBM	M	30	30	E
FCDA Holdings	M	RBM	M	30	30	E
RBM foreign exchange cash flow	M	RBM	M	30	30	E
Foreign exchange exposure limits by bank	M	RBM	M	30	30	E
Bank statements of the Health SWAp account held at RBM	M	RBM	M	30	30	E
Full banking survey (on monthly basis)	M	RBM	M	45	15	E
Financial soundness indicators by banks	Q	RBM	Q	45	T15	E
NAC consolidated statement of sources and uses of funds (cashflow stateme	M	MOF	M	30	30	E
Health SWAp statement of sources and uses of funds	M	MOF	M	30	30	E
Fiscal table (GFS) including revenue, expenditure, and financing	M	MOF	M	30	30	E
Revenue data (from MRA)	M	MOF	M	30	30	E
D\ata on expenditure for domestically financed capital projects	M	MOF	M	30	30	E
New external loans contracted or guaranteed by the central government[1]	Q	MOF	Q	30	T30	E
External debt services (actual and projections)	Q	MOF	Q	30	T30	E
Borrowing of all major parastatals[2]	Q	MOF	Q	45	T15	E
Annual Financial reports of the nine (9) major parastatals and MSB	A	MOF	Q	90	30	H
Report on IMF program performance	Q	MOF	Q	45	T15	E
Statement on new arrears	Q	AuG	Q	45	T15	E
Consumer price index and monthly statistical bulletin	M	NSO	M	30	30	E
Import and export data	M	NSO	M	45	T15	E
Balance of payments, and quarterly statistical bulletin	Q	NSO	Q	45	T15	E
National accounts, balance of payments, and quarterly statistical bulletin	A	NSO	BA	45	T15	E

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

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

[2] Agriculture Development and Marketing Corporation (ADMARC), Electric Supply Company of Malawi (ESCOM), Blantyre Water Board, Lilongwe Water Board, Southern Region Water Board, Northern Region Water Board, Central Region Water Board, Malawi Housing Corporation, Malawi Communications Regulatory Authority.

MALAWI

March 5, 2015

FIFTH AND SIXTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR WAIVERS FOR NON-OBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, MODIFICATION OF PERFORMANCE CRITERION, AND REPHASING OF DISBURSEMENTS—DEBT SUSTAINABILITY ANALYSIS

Approved By
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Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

This debt sustainability analysis for low-income countries (DSA) confirms a moderate risk of external debt distress for Malawi. Except for the present value of external public debt to GDP—which displays a marginal and temporary breach during 2014–15, external debt burden indicators remain below their indicative thresholds under bound tests conducted to show the impact of temporary shocks. However, total public debt has increased substantially in recent years. In the context of a weak institutional environment, such rapid growth of public debt poses a heightened overall risk of debt distress.

BACKGROUND

1. The last Low Income Country Debt Sustainability Analysis (LIC DSA, IMF country report no. 14/37) conducted in late 2013 concluded Malawi's external public debt faced moderate risk of distress. All external public debt and debt burden indicators for Malawi were envisioned below their respective thresholds under the benchmark and other scenarios. The baseline envisioned strong enough fiscal and public financial management (PFM) policies that would result in resumption in donor budget support by the end of the 2013/14 fiscal year, but this did not materialize.

2. The country policy and institutional assessment (CPIA) score for Malawi has deteriorated, changing the category of its policies and institutions to weak, and tightening debt thresholds for DSA analysis. The CPIA score of Malawi peaked at 3.4 in 2007 but has continuously deteriorated since then and reached a level of 3.1 by 2013, compounded by erosion in the effectiveness of public financial management systems, controls and oversight mechanisms. Relative to the previous DSA, weak policies and institutions as measured by this index resulted specifically in lower thresholds for external public debt relative to the ones used in the previous DSA.[1]

3. Malawi's public and publicly guaranteed (PPG) gross debt changed from 57% of GDP in 2012 to 72.1% of GDP in 2013 and is expected to reach about 76% of GDP in 2014, reflecting continued increases in both, domestic and external public debt. The increase in debt reflected in part (two-thirds of the change from 2012 to 2013) recourse to domestic financing in the wake of external financing shortfalls arising from the suspension of external budget support by donors in the wake of weaknesses revealed by a large public financial management scandal. Popularly known as "cashgate", this scandal involved multiple cases of embezzlement of public funds by a number of officials of the government. The increase in total public debt in 2014 also resulted in part from the recognition of significant past payment arrears. A decline in government current expenditures as ratio to GDP and improved domestic revenue performance were insufficient in offsetting the ongoing lack of direct budget support from development partners. A detailed decomposition of the dynamics of domestic and external public debt is discussed below.

Text Table 1. Malawi: Composition of total public Debt, 2012–14
(Percent of GDP)

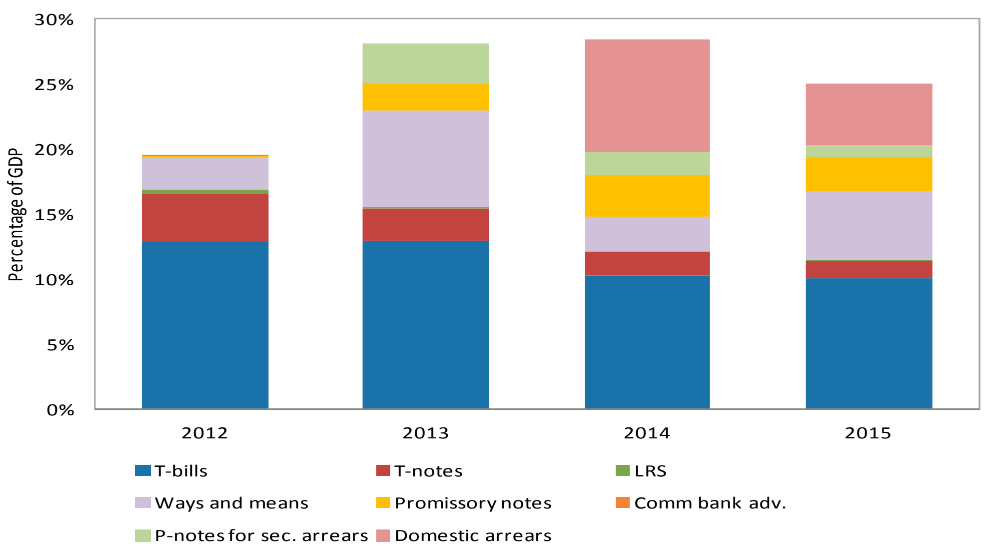
	2012	2013	2014
External debt	37.7	44.0	47.3
Domestic Debt	19.5	28.1	28.5
Total public Debt	57.2	72.1	75.8

Sources: Malawian Authorities and IMF Staff Estimates.

[1] The new thresholds for the indicators related to the present value of public and publicly guaranteed external debt are: 30 percent as a ratio to GDP (down from 40 percent); 100 percent as a ratio to exports (down from 145 percent); and 200 percent as a ratio to revenue (down from 250 percent). Similarly, the thresholds for debt service indicators changed from: 20 to 15 percent, as a ratio to exports, and from 20 to 18 percent as a ratio to revenue.

4. Gross domestic debt increased from MK206.6 billion (19.5% of GDP) at the end of 2012 to MK515 billion (28.5% of GDP) at the end of 2014. As illustrated in Figure A1, this increase is largely due to (i) the rise in the use of ways and means advances from the Reserve Bank of Malawi in 2013 and 2014, following the drop in external financing in the wake of the "cashgate" scandal; (ii) the recognition in late 2014 of pre-audited arrears amounting to MK157 billion (8 percent of GDP) accumulated from previous fiscal years; (iii) the issuance of promissory notes in the amount of MK29 billion (1.6 percent of GDP) by the government to the central bank (RBM) in April 2014 to cover losses arising from the 2012 devaluation of the exchange rate. Gross domestic debt as a percent of GDP is projected to gradually decline from 25 percent of GDP at end-2015 to 15 percent of GDP at end-2020, helped by (i) the repayment of accumulated domestic arrears; (ii) the decline in new ways and means advances as the government's fiscal position improves; and (iii) a projected slower pace of new issuance of Treasury bills and Treasury notes over the long term (due to a lower government deficit).

Figure A1. Composition of the Stock of Gross Domestic Debt



Sources: Malawi authorities and IMF staff calculations

5. Malawi's external public debt increased from US $1.15 billion in 2012 (37.7% of GDP) to US $1.45 billion on 2013 (44% of GDP) and is estimated to have reached US $1.86 (47.3% of GDP) billion in 2014.. The increase of 2013 reflects a continuation of strong external borrowing that resumed in 2012. In terms of GDP half of the increase of the change from 2012 to 2013 can be attributed to exchange rate effects.[2] External support was then subdued in late 2013. During 2014 external public debt increased further, but about half of the increase was due not to accumulation of new debt, but to the sale of existing domestic debt to PTA bank, a regional development bank serving the members of the Common Market of East and Southern Africa (COMESA). The debt was reclassified as external based on the residency criterion despite the debt being denominated in local currency. In terms of source of financing, as illustrated in Table 1 below, most of Malawi's debt is from multilaterals.

[2] The year-on-year Kwacha-Dollar exchange rate depreciated by about 30% in 2013. External debt is converted in Kwacha using end of period exchange rate, which was about 15% higher than the average exchange rate.

Text Table 2. Composition of Total Public and Publicly Guaranteed External Debt
(US$ Millions)

	2012	2013		2014	
	Actual	Actual	Share	Proj.	Share
Total	1149.5	1447.38	100%	1857.4	100.0%
Multilaterals	882.7	1015.2	70%	1365.2	74%
IMF	180.9	198.2	14%	218.2	12%
IDA	322.9	416.5	29%	456.5	25%
ADF	171.2	190.9	13%	210.9	11%
IFAD	77.6	75.6	5%	75.6	4%
Other Multilateral[1]	130.1	134	9%	424.0	23%
Bilateral	266.8	412.5	28%	472.5	25%
France	10.4	10.8	1%	10.8	1%
Belgium	2.2	2.2	0%	2.2	0%
People's Republic of China	175.5	252.4	17%	282.4	15%
India	78.7	106.2	7%	136.2	7%
Others	0	40.9	3%	40.9	2%
Commercial	0	19.7	1%	19.7	1%

Sources: Malawian authorities and staff estimates

[1]The 2014 stock includes US$250 million resulting from the sale of existing government debt to a regional development bank.

6. The scope of debt covered in the present DSA encompasses public and publicly guaranteed debt.

UNDERLYING DSA ASSUMPTIONS

7. Macroeconomic and policy developments during 2013 and 2014 resulted in several areas of underperformance, relative to the projections in the 2013 DSA. Donors withdrew budget support in 2013 and this when combined with weak commitment controls (which were exacerbated in the run up to elections), contributed to increased domestic borrowing, domestic payment arrears and an acceleration in inflation. Economic activity remained resilient, with real GDP estimated at 5½–6 percent range in 2014. The ready availability of foreign exchange and fuel, as a result of policy reforms introduced in May 2012, appears to have supported the expansion of economic activity. The exchange rate came under considerable depreciation pressure in the latter stages of 2014. This was in part a seasonal phenomenon, as the rate usually weakens after the end of the tobacco buying season in August. However, it was particularly acute this time, owing to the unattractive level of real interest rates. The exchange rate begun to stabilize since the stance of monetary policy was tightened in November and the RBM acquired foreign exchange from the debt restructuring operation with PTA.

8. The baseline scenario and macroeconomic outlook have been revised accordingly. For Fiscal year 2014/2015, government expenditures in goods and services, wages, and development are projected 2 percentage points of GDP lower than in the previous DSA. Monetary policy is also expected to remain tight, to support the disinflation process. Tighter policies, and lower than expected worldwide growth, led to revisions in GDP growth forecasts for 2014 and 2015 to 5.7 percent and 5.5 percent, respectively (from 6.1 percent and 6.5 percent in the previous DSA). Long-term GDP growth is assumed at 6 percent. The baseline scenario also maintains the assumption of a gradual reduction in the external current account deficit through export diversification and reliance on grants and concessional financing in the medium term. The merchandise trade balance is expected to improve during 2014 and 2015 relative to the previous DSA, on account of favorable terms of trade and the continued depreciation of the Kwacha. Inflation is programmed to return to single digits by 2016. Targets on international reserves have been met during the program, and a 3 months of import cover is expected to be attained and sustained (or improved) by end-2015. The key macroeconomic assumptions are summarized in Box 1.

Box 1. Baseline Macroeconomic Assumptions

Real GDP is projected to grow at an annual rate of about 6 percent over the longer term, led by the agriculture, trade, manufacturing and mining sectors, and supported by a more competitive exchange rate, structural reforms, and gradually recovering donor support.

Inflation is projected to decline from 24.2 percent by end of the period 2014 to 12 percent by December 2015 and to reach single digits by 2016 as the emphasis of monetary policy switches from accumulation of international reserves to price stability.

The exchange rate is projected to remain constant in real terms after 2015.

Tax revenue is projected to continue increasing with ongoing reforms in tax administration and policy.

External public debt and financing sources. Debt will be contracted mainly from multilateral creditors on concessional terms, with borrowing from bilateral sources also on broadly similar terms. Budget support from development partners is assumed to remain subdued for FY 2014/15 and into the medium term. Project support in the short and medium term is assumed to remain strong (but lower than previously considered). Foreign direct investment is still assumed to be in the 3–4% of GDP range in the short to medium term as strong reforms bring back confidence, while the longer term levels are as in previous DSA analyses, in the range of 1–2% of GDP.

The current account balance will remain at a sustainable level, as improvements in the trade of goods and services balances partially offset the decline in grants.

Text Table 3. Macroeconomic Forecasts and Assumptions (Previous and Current DSA)

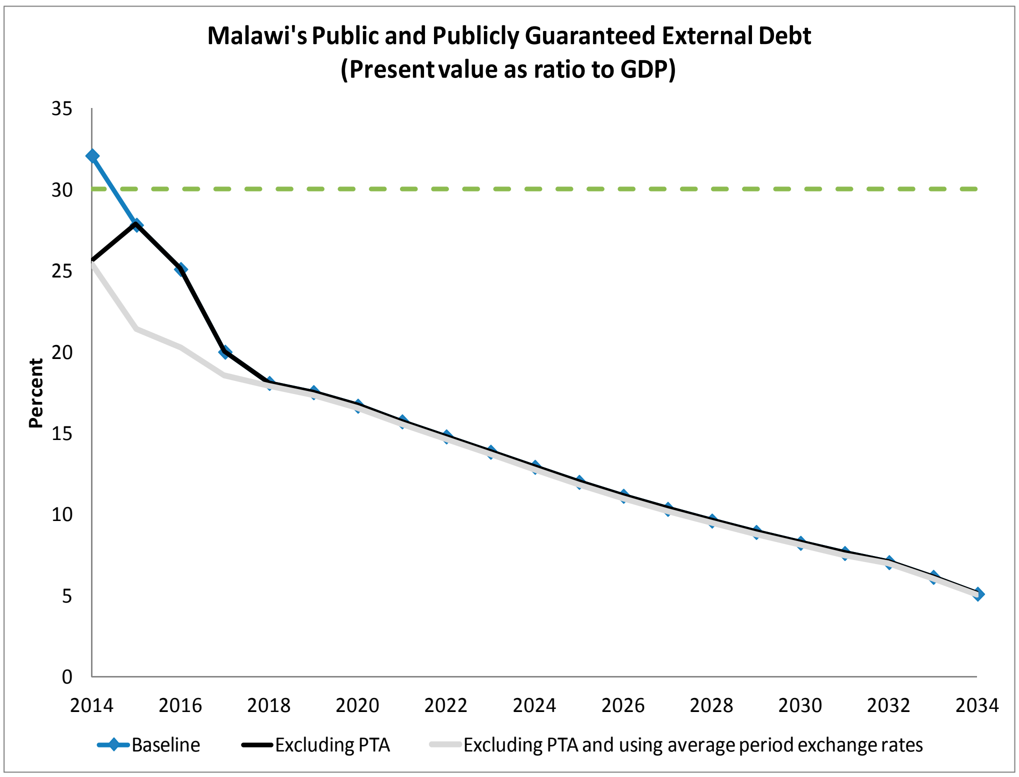
	Real GDP growth		Primary deficit (percent of GDP)		Change in public debt (percent of GDP)	
Year	Previous	Current	Previous	Current	Previous	Current
2013	5.0	5.2	1.2	1.9	12.0	14.9
2014	6.1	5.7	-1.3	-1.6	-13.5	3.7
2015	6.5	5.5	-0.4	-0.9	-5.5	-15.5
2016	6.5	5.7	-0.9	-3.1	-4.3	-3.3
2017	6.2	6.0	0.1	-2.4	-3.2	-6.2
2018	6.3	5.9	0.1	-0.9	-5.1	-1.1
2019	5.9	5.8	1.2	-1.2	-3.1	-1.9
2020	5.8	5.9	1.0	-0.5	-3.5	-1.9
2021	5.9	5.9	1.4	-0.6	-2.3	-1.9
2022	5.9	6.0	1.4	-1.1	-1.9	-2.2
Avg 2023-2034	5.9	6.0	1.2	1.0	-0.2	-2.0

Sources: Malawian authorities and IMF staff calculations and projections.

EXTERNAL PUBLIC DEBT SUSTAINABILITY

9. Except for the present value (PV) of external public debt to GDP, which displays a marginal and temporary breach during 2014–2015, external debt indicators for Malawi remain below their new tighter limits. Malawi's external public debt continued expanding through 2013 and, in present value terms, is estimated to reach 32.2% of GDP by the end of 2014. The resulting breach in the corresponding debt threshold (of 30%) is, nevertheless, expected to be marginal and short lived. As illustrated in Figure A2 below, this breach was due to the aforementioned restructuring of existing domestic debt to PTA bank. The interest rate would be lower by 1000 basis points as a result of the restructuring, resulting in lower debt service costs. PTA bank finances letters of credit for exports in Malawi on a regular basis and thus benefits from the resulting liquidity. In addition to this restructuring operation, the depreciation of the exchange rate during the last quarter of 2014, which appears to have subsided in recent times, also played an important role in causing the breach in the PV of debt to GDP threshold.[3]

Figure A2. Malawi's Public and Publicly Guaranteed External Debt



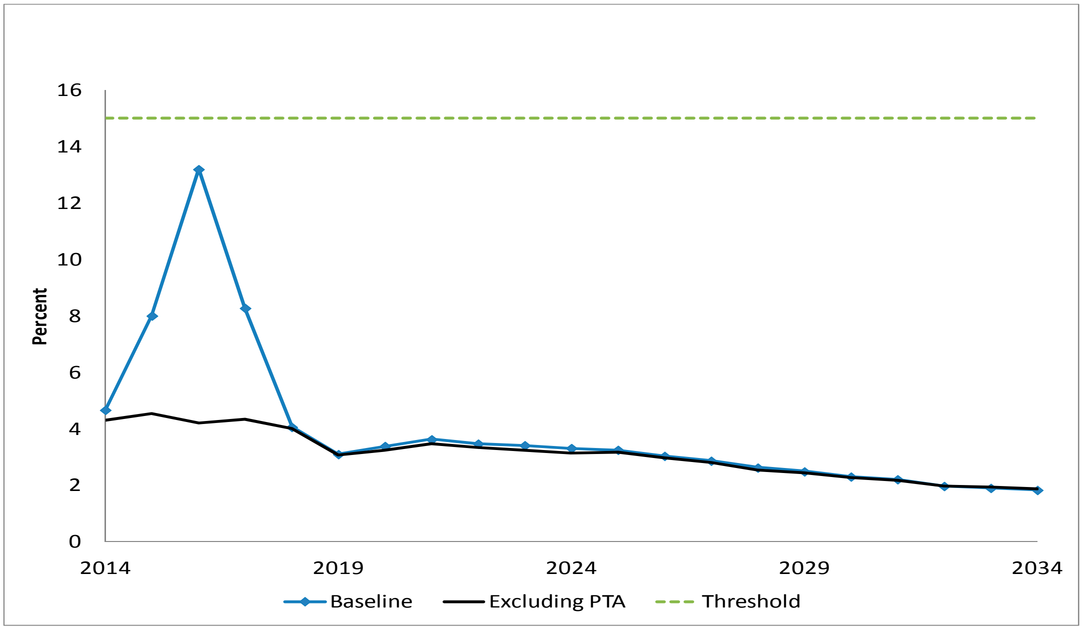
Sources: Malawian Authorities and IMF Staff Calculations

[3] The DSA template employs end of period exchange rate to compute present value of flows of debt service. Of course, not all debt service occurs at the end of the period. In times with sharp exchange rate movements, this artificially inflates external debt indicators. Indeed, Figure A2 shows if one used average exchange rates the threshold for PV of PPG external debt would not be breached.

Another noticeable change, relative to the dynamics of debt in previous DSA, is that, due to the short maturity (3 years) of the loan with PTA, noticeable peaks in debt service emerge during 2015–16.[4] An illustration of debt service trends in the baseline, and excluding PTA is presented in Figure A3. Restrained fiscal and monetary policies, together with PFM reforms envisioned in the current ECF (Extended Credit Facility) program should contribute to a downward trend in key debt indicators.

Figure A3. Malawi's Public and Publicly Guaranteed External Debt Service

(Debt Service as Ratio of Exports)



Sources: Malawian Authorities and IMF Staff Calculations

10. Except for the present value of external public debt to GDP, debt burden indicators remain below their indicative thresholds under bound tests conducted to show the impact of temporary shocks. The strongest impact on the present value of external public debt to GDP requires the combination of shocks to growth, exports and non-debt creating flows (See Table 4a, case B5). In turn, a shock to exports (Table 4a, case B2) is the only shock that could bring a marginal breach in the debt to exports ratio while none of the bound tests considered results in a breach of threshold for the present value of debt to revenue ratio.

STRESS TESTS

11. Standard stress tests indicate that a somewhat weaker debt outcome is possible under certain conditions (Figure 1). Specifically, the present value of debt to GDP ratio remains above its indicative threshold when key variables are kept at their historical levels. This behavior is mostly due to the inclusion of 2012 in the historical period, which effectively allows the exchange rate depreciation in that year to continue to impact nominal GDP in U.S. dollars. The staff considers this to be an unlikely outcome due to authorities' actions to reduce fiscal dominance.

[4] It is important to note that restructuring of debt is not subject to the zero-limit on non concessional external debt.

PUBLIC DEBT SUSTAINABILITY

12. Total public debt has increased substantially and, in present value terms, stands seventeen percentage points of GDP higher than the recommended benchmark. Domestic debt has expanded in recent years, in part to cover for the decline in traditional budget support from development partners, but also due to weaknesses in public financial management that gave rise to arrears and budget overruns.[5] By 2013 the present value of total public debt stood at 55.9 percent of GDP, and is expected to peak at 60.7 percent by the end of 2014, partly due to new uncovered arrears (157 billion KW), and in part due to issuance of securities to recapitalize the central bank (29 billion KW). The strong PFM reforms, monetary and fiscal policies envisioned in the present ECF program should contribute towards restoring donor confidence (and bring back external financing), and keeping expenditures within the available fiscal envelope. Domestic debt as a share of GDP is set to decline with fiscal consolidation and the maintenance of a positive primary balance. Standard stress tests suggest that the debt dynamics would deteriorate relative to the baseline (Figure 2 and Table 2). The strongest impact on the indicators arises from a one-time real depreciation shock—again through compression of nominal GDP in U.S. dollars—and an export shock, which is illustrative of the risk inherent in the undiversified nature of Malawi's sources of foreign exchange.[6]

13. External financing risks exist, but are projected to be addressed by additional fiscal restraint and so should not have an impact on debt. Budget financing needs required, as in FY2013/2014, an expansion of domestic debt for fiscal year 2014/2015. Fiscal tightening is expected to be the policy response to unexpected negative financing shocks (either from delayed or lower donor support, or lower tax revenue). Additional domestic borrowing would bring additional pressures on the exchange rate and erode perceptions of government commitment to policy reforms, ultimately damaging macroeconomic performance and should be avoided. The authorities should look for additional cuts in domestically financed development expenditure and in goods and services to meet additional shortfalls in external financing. Risks to this include the delicate balance of maintaining macroeconomic stability, versus maintaining core public services – especially for the poor – should government struggle to raise sufficient domestic revenue and/or fail to see a resumption of budget support. Similarly, the government may have to continue confronting political economy challenges of reducing expenditure in politically charged areas, such as fertilizer subsidies, wages and salaries, etc.

14. Malawi's external public debt remains at moderate risk of debt distress. However, rapid accumulation of debt and deterioration in the strength of the policy and institutional framework (as measured by the CPIA score) urge prudent debt management policies to guarantee the sustainability of debt.

[5] It is important to note that, relative to the previous DSA for Malawi, the current analysis reflects bringing a large amount of arrears that were previously off-budget on to the budget through securitization.

[6] In this analysis, the combination bound test B5 (Tables 4a and b) was modified to exclude the non-debt creating flows component. This component was removed as Malawi lacks the access to capital markets required to replace lost grants and foreign investment with borrowing, and would instead be forced to respond with expenditure and import compression.

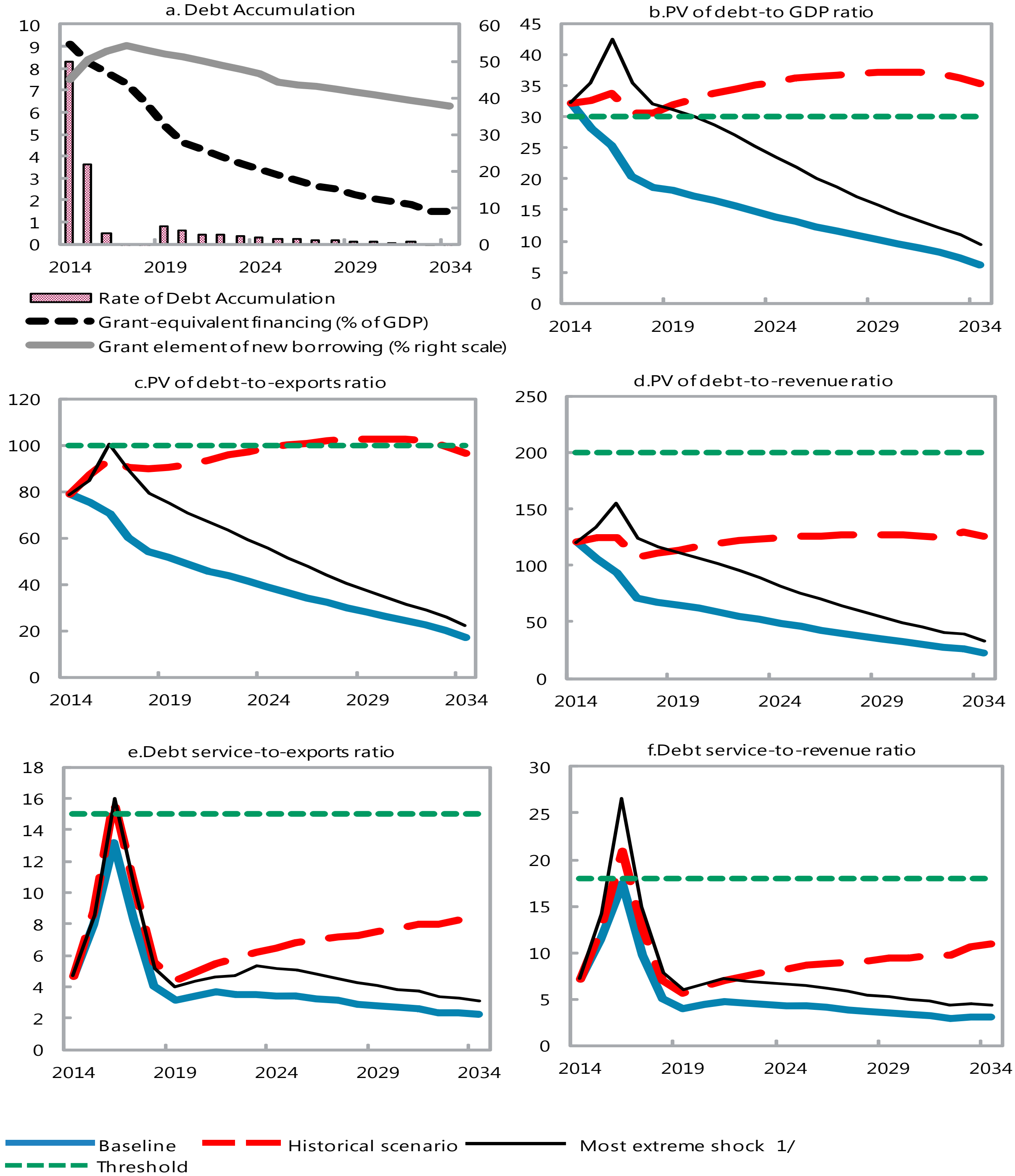
15. Authorities' views. The authorities recognized that Malawi's external public debt to GDP ratio has been growing and is expected to reach 32.2 percent of GDP in net present value terms at end-2014. Nonetheless, they noted that this is not expected to worsen the debt dynamics significantly, as external public debt remains mostly concessional. They pointed out that external public debt service burden remains low, with a debt service ratio in 2014 of only 4.7 percent of exports of goods and services. However, they acknowledged that domestic debt burden is becoming more worrisome and that domestic debt accumulation increased, in part, due to the fact that the "cashgate" scandal resulted in annual shortfalls in external disbursements amounting to almost 6.6 percent of GDP. Furthermore, the authorities noted that their PFM systems proved too weak to enforce the discipline needed to follow the adjustment path agreed under the program. By the end of the 2013/14 fiscal year, domestic financing had increased to about 6 percent of GDP. The authorities emphasized efforts to regularize these and additional payment arrears accumulated from previous years and reforms geared towards strengthening commitment controls.

16. The authorities viewed 2015 as a year to consolidate debt and lay the groundwork for a period of sustained noninflationary growth. In this regard, they envisaged real growth in 2015 to reach 5.5 percent (one percentage point lower than anticipated in the December 2013 MEFP) and to gradually increase to 6 percent in 2017. Inflation will decline to 12.5 percent by end-2015 and to single digit levels towards end-2016. Fiscal restraint and a reliance on concessional foreign borrowing for the majority of financing needs will allow some reduction in the stock of domestic debt relative to GDP to take place. Strong debt management in the near-to medium term will be implemented to ensure that debt is sustainable and the right balance of costs and risks is achieved. They underscored that improvements in debt management would be achieved by resuscitating the Debt Management Committee whose membership will be at senior level, which will look at each borrowing, to ascertain its concessionality and to insure debt sustainability. They reaffirmed their commitment to implementing the Debt Management Reform Programme, that was agreed with IMF and World Bank that is aimed at strengthening the debt management capacity of the Debt and Aid Management Division.

CONCLUSIONS

17. Malawi's debt situation remains at a moderate risk of distress, based on an assessment of external public debt, but with a heightened overall risk of debt distress, reflecting significant vulnerabilities related to domestic debt. Risk of export related shocks remains, given Malawi's limited sources of foreign exchange and reliance on rain-fed agriculture. Additional risks include the loosening of policies as a response to the decline in the volume of donor support, which could further erode donor confidence and jeopardize the resumption of aid. Risks of negative financing shocks in the form of delayed or lower donor support, or lower than expected tax revenue may require additional fiscal restraint, but should not compromise the medium-term debt sustainability of the country. Recent events point to the need for taking steps to arrest the decline in the quality of institutions (as reflected in the CPIA score), to ensure capacity to manage the debt load of the country.

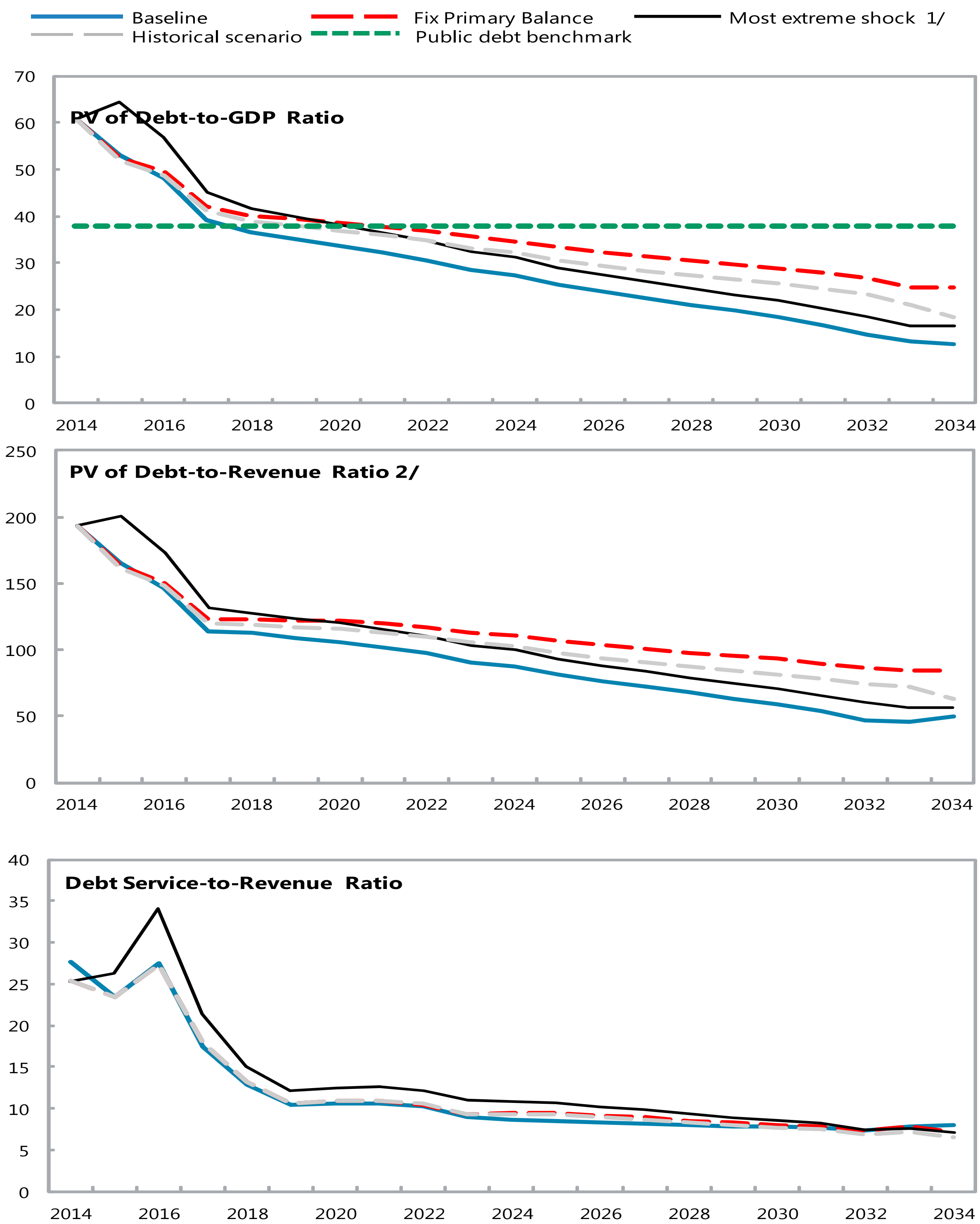
Figure 1. Malawi: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2014–34



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

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a Combination shock; in c. to a Exports shock; in d. to a Combination shock; in e. to a Exports shock and in figure f. to a GDP deflator shock

Figure 2. Malawi: Indicators of Public Debt under Alternative Scenarios, 2014–34



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

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.
2/ Revenues are defined inclusive of grants.

Table 1. Malawi: External Debt Sustainability Framework, Baseline Scenario, 2011–14

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2034	2020-2034 Average
External debt (nominal) 1/	**21.0**	**42.8**	**49.7**			**52.1**	**40.2**	**39.3**	**37.1**	**36.5**	**35.8**		**29.1**	**16.2**	
of which: public and publicly guaranteed (PPG)	16.9	37.7	44.0			47.3	35.3	34.1	31.9	31.5	30.7		24.0	11.1	
Change in external debt	0.5	21.9	6.9			2.4	-11.9	-0.9	-2.2	-0.6	-0.8		-1.4	-1.8	
Identified net debt-creating flows	4.0	8.6	3.7			0.6	-0.8	-1.0	-1.3	-1.3	-1.4		-1.4	-1.1	
Non-interest current account deficit	**5.8**	**3.2**	**1.5**	**5.5**	**4.3**	**4.6**	**2.4**	**2.0**	**2.2**	**2.0**	**1.9**		**1.3**	**0.5**	1.0
Deficit in balance of goods and services	14.7	20.5	18.0			14.9	13.7	12.3	11.6	9.2	8.7		7.6	6.6	
Exports	25.1	33.4	42.5			41.0	37.4	35.9	33.8	34.2	35.1		36.1	36.4	
Imports	39.8	53.8	60.5			55.8	51.0	48.2	45.4	43.4	43.8		43.7	43.0	
Net current transfers (negative = inflow)	-10.9	-20.2	-20.4	-16.3	3.3	-14.9	-14.8	-15.0	-13.8	-12.7	-12.0		-9.5	-6.8	-8.5
of which: official	-6.4	-14.0	-13.2			-6.6	-7.7	-7.7	-7.4	-6.4	-6.0		-4.4	-2.6	
Other current account flows (negative = net inflow)	1.9	3.0	4.0			4.6	3.6	4.6	4.4	5.5	5.2		3.1	0.7	
Net FDI (negative = inflow)	**-1.1**	**-1.9**	**-2.4**	**-2.1**	**1.3**	**-2.0**	**-2.0**	**-1.7**	**-1.7**	**-1.6**	**-1.6**		**-1.2**	**-0.8**	-1.0
Endogenous debt dynamics 2/	**-0.7**	**7.3**	**4.6**			**-2.0**	**-1.3**	**-1.3**	**-1.8**	**-1.7**	**-1.7**		**-1.4**	**-0.8**	
Contribution from nominal interest rate	0.1	0.3	0.3			0.5	1.2	0.7	0.3	0.3	0.3		0.3	0.2	
Contribution from real GDP growth	-0.9	-0.5	-2.5			-2.5	-2.5	-2.0	-2.1	-2.0	-2.0		-1.7	-1.0	
Contribution from price and exchange rate changes	0.1	7.5	6.8			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-3.4**	**13.3**	**3.1**			**1.9**	**-11.1**	**0.1**	**-0.9**	**0.7**	**0.6**		**0.0**	**-0.7**	
of which: exceptional financing	-2.2	-2.2	-2.6			-4.4	-4.1	-3.6	-3.1	-2.8	-2.1		-1.5	-0.7	
PV of external debt 4/	...	...	33.5			37.0	32.9	30.5	25.5	23.5	23.1		19.1	11.3	
In percent of exports	...	...	78.9			90.4	88.2	85.0	75.4	68.9	65.8		52.8	31.1	
PV of PPG external debt	**...**	**...**	**27.8**			**32.2**	**28.0**	**25.3**	**20.3**	**18.5**	**18.0**		**14.0**	**6.2**	
In percent of exports	**...**	**...**	**65.4**			**78.6**	**74.9**	**70.5**	**60.1**	**54.1**	**51.3**		**38.7**	**17.1**	
In percent of government revenues	**...**	**...**	**107.4**			**120.3**	**106.1**	**92.8**	**70.9**	**67.2**	**64.5**		**48.7**	**22.2**	
Debt service-to-exports ratio (in percent)	**1.4**	**2.0**	**4.6**			**4.7**	**8.0**	**13.2**	**8.3**	**4.1**	**3.1**		**3.4**	**2.2**	
PPG debt service-to-exports ratio (in percent)	**1.4**	**2.0**	**4.6**			**4.7**	**8.0**	**13.2**	**8.3**	**4.1**	**3.1**		**3.4**	**2.2**	
PPG debt service-to-revenue ratio (in percent)	**1.5**	**2.9**	**7.5**			**7.1**	**11.3**	**17.4**	**9.8**	**5.0**	**3.9**		**4.3**	**3.1**	
Total gross financing need (Billions of U.S. dollars)	0.3	0.1	0.1			0.2	0.2	0.3	0.2	0.1	0.1		0.1	0.2	
Non-interest current account deficit that stabilizes debt ratio	5.2	-18.6	-5.3			2.2	14.4	2.9	4.4	2.6	2.7		2.6	2.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.3	1.9	5.2	5.5	2.8	5.7	5.5	5.7	6.0	5.9	5.8	5.8	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	-0.3	-26.5	-13.7	-0.1	11.5	5.5	9.9	9.2	5.5	4.0	1.3	5.9	1.9	2.2	2.0
Effective interest rate (percent) 5/	0.5	0.9	0.6	0.7	0.2	1.2	2.7	2.1	1.0	0.8	0.9	1.4	0.9	1.0	1.0
Growth of exports of G&S (US dollar terms, in percent)	3.6	-0.3	15.7	14.0	15.2	7.5	5.8	11.0	5.2	11.5	10.3	8.5	8.1	8.6	8.4
Growth of imports of G&S (US dollar terms, in percent)	-7.8	1.3	2.1	10.5	15.6	2.9	6.0	9.2	5.3	5.2	8.4	6.2	7.7	8.4	8.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	44.9	50.4	52.7	54.3	53.2	52.1	51.3	46.6	37.8	43.6
Government revenues (excluding grants, in percent of GDP)	23.7	23.1	25.9			26.8	26.4	27.3	28.6	27.6	28.0		28.6	28.1	28.8
Aid flows (in Billions of US dollars) 7/	0.5	0.7	0.6			0.3	0.5	0.5	0.5	0.5	0.5		0.4	0.3	
of which: Grants	0.3	0.5	0.3			0.2	0.3	0.3	0.4	0.3	0.3		0.3	0.3	
of which: Concessional loans	0.3	0.2	0.2			0.1	0.2	0.2	0.2	0.2	0.1		0.1	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			9.1	8.3	7.8	7.3	6.5	5.4		3.4	1.5	2.8
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			62.4	76.2	80.4	83.2	82.5	84.0		80.5	91.1	80.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	5.6	4.2	3.8			4.3	4.9	5.7	6.4	7.0	7.5		11.0	24.2	
Nominal dollar GDP growth	4.1	-25.1	-9.2			11.5	16.0	15.5	11.8	10.1	7.2	12.0	8.0	8.3	8.1
PV of PPG external debt (in Billions of US dollars)			0.9			1.2	1.4	1.4	1.3	1.3	1.3		1.5	1.6	
(PVt-PVt-1)/GDPt-1 (in percent)						8.3	3.7	0.5	-2.1	-0.4	0.8	1.8	0.3	-0.4	0.2
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	27.8			32.2	28.0	25.3	20.3	18.5	18.0		14.0	6.2	
PV of PPG external debt (in percent of exports + remittances)	...	...	65.4			78.6	74.9	70.5	60.1	54.1	51.3		38.7	17.1	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	4.6			4.7	8.0	13.2	8.3	4.1	3.1		3.4	2.2	

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

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Malawi: Public Sector Debt Sustainability Framework, Baseline Scenario, 2011–34

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2011	2012	2013	Average 5/	Standard Deviation 5/	2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
Public sector debt 1/	40.0	57.2	72.1			75.8	60.2	56.9	50.7	49.7	47.7		37.5	17.4	
of which: foreign-currency denominated	16.9	37.7	44.0			47.3	35.3	34.1	31.9	31.5	30.7		24.0	11.1	
Change in public sector debt	4.9	17.2	14.9	0.0		3.7	-15.5	-3.3	-6.2	-1.1	-1.9		-1.6	-1.5	
Identified debt-creating flows	3.5	10.2	1.0			-7.2	-9.9	-5.3	-5.7	-2.1	-3.1		-2.2	-0.9	
Primary deficit	2.0	0.2	1.9	-0.6	3.2	-1.6	-0.9	-3.1	-2.4	-0.7	-1.4	-1.7	-0.5	0.3	-1.1
Revenue and grants	28.3	34.6	34.0			31.4	32.0	33.0	34.2	32.5	32.3		31.3	29.3	
of which: grants	4.7	11.6	8.1			4.6	5.6	5.7	5.6	4.9	4.3		2.7	1.2	
Primary (noninterest) expenditure	30.3	34.8	35.9			29.8	31.1	29.9	31.8	31.8	30.9		30.8	29.5	
Automatic debt dynamics	1.7	10.2	-0.9			-5.7	-9.0	-2.3	-3.4	-1.5	-1.7		-1.7	-1.1	
Contribution from interest rate/growth differential	0.7	-2.3	-1.9			-2.5	-1.1	-0.8	-1.7	-1.6	-1.9		-1.7	-0.8	
of which: contribution from average real interest rate	2.2	-1.6	0.9			1.4	2.8	2.4	1.5	1.3	0.8		0.5	0.3	
of which: contribution from real GDP growth	-1.5	-0.7	-2.8			-3.9	-3.9	-3.3	-3.2	-2.8	-2.7		-2.2	-1.1	
Contribution from real exchange rate depreciation	1.0	12.5	1.0			-3.2	-7.9	-1.4	-1.7	0.1	0.2		...	...	
Other identified debt-creating flows	-0.3	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.3	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.4	7.0	13.9			10.9	-5.6	2.0	-0.5	1.1	1.1		0.6	-0.7	
Other Sustainability Indicators															
PV of public sector debt	...	19.5	55.9			60.7	53.0	48.1	39.1	36.7	35.1		27.4	12.5	
of which: foreign-currency denominated	...	0.0	27.8			32.2	28.0	25.3	20.3	18.5	18.0		14.0	6.2	
of which: external	...	...	27.8			32.2	28.0	25.3	20.3	18.5	18.0		14.0	6.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.6	3.6	9.8			7.1	6.6	6.0	3.6	3.5	2.0		2.2	2.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	56.4	164.6			193.3	165.4	146.0	114.3	112.9	108.7		87.6	42.7	
PV of public sector debt-to-revenue ratio (in percent)	...	84.7	216.2			226.7	200.8	176.4	136.6	133.1	125.4		95.8	44.6	
of which: external 3/	...	...	107.4			120.3	106.1	92.8	70.9	67.2	64.5		48.7	22.2	
Debt service-to-revenue and grants ratio (in percent) 4/	12.6	9.8	23.2			27.6	23.5	27.5	17.5	12.9	10.5		8.6	8.0	
Debt service-to-revenue ratio (in percent) 4/	15.1	14.8	30.4			32.4	28.5	33.3	20.9	15.3	12.1		9.4	8.3	
Primary deficit that stabilizes the debt-to-GDP ratio	-2.9	-17.1	-12.9			-5.3	14.6	0.3	3.8	0.4	0.6		1.1	1.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.3	1.9	5.2	5.5	2.8	5.7	5.5	5.7	6.0	5.9	5.8	5.8	6.0	6.0	6.0
Average nominal interest rate on forex debt (in percent)	1.4	2.3	1.5	1.6	0.4	2.7	5.3	4.1	2.0	1.7	1.7	2.9	1.9	2.1	1.9
Average real interest rate on domestic debt (in percent)	12.5	-7.2	4.7	6.5	8.1	3.7	5.0	7.2	7.1	7.7	5.5	6.0	4.1	5.1	4.5
Real exchange rate depreciation (in percent, + indicates depreciation)	6.6	75.3	2.8	5.3	25.3	-7.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.0	17.7	27.3	13.7	8.2	20.9	16.5	8.7	6.8	6.8	6.5	11.0	5.6	5.5	5.7
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.6	16.9	8.6	2.4	5.9	-12.4	10.1	1.7	12.9	5.8	2.8	3.5	9.3	5.0	5.7
Grant element of new external borrowing (in percent)	...	...	...	...	...	44.9	50.4	52.7	54.3	53.2	52.1	51.3	46.6	37.8	...

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

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3. Malawi: Sensitivity Analysis for Key Indicators of Public Debt 2014–34

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of Debt-to-GDP Ratio								
Baseline	61	53	48	39	37	35	27	13
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	61	52	49	41	39	38	32	18
A2. Primary balance is unchanged from 2014	61	52	50	42	40	39	35	23
A3. Permanently lower GDP growth 1/	61	52	48	39	38	37	34	32
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	61	53	51	43	41	40	37	27
B2. Primary balance is at historical average minus one standard deviations in 2015-201	61	54	52	43	41	39	31	15
B3. Combination of B1-B2 using one half standard deviation shocks	61	54	52	43	41	40	34	19
B4. One-time 30 percent real depreciation in 2015	61	64	57	45	42	40	31	17
B5. 10 percent of GDP increase in other debt-creating flows in 2015	61	58	53	43	41	39	31	15
PV of Debt-to-Revenue Ratio 2/								
Baseline	193	165	146	114	113	109	88	50
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	193	162	148	120	119	117	102	63
A2. Primary balance is unchanged from 2014	193	163	150	123	123	122	111	79
A3. Permanently lower GDP growth 1/	193	162	145	115	115	113	107	109
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	193	166	154	123	125	124	116	91
B2. Primary balance is at historical average minus one standard deviations in 2015-201	193	168	159	126	125	121	98	51
B3. Combination of B1-B2 using one half standard deviation shocks	193	167	157	125	126	123	108	67
B4. One-time 30 percent real depreciation in 2015	193	201	173	132	128	123	100	57
B5. 10 percent of GDP increase in other debt-creating flows in 2015	193	181	160	126	125	121	98	51
Baseline	28	24	28	18	13	10	9	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	25	24	27	18	13	11	9	7
A2. Primary balance is unchanged from 2014	25	24	27	18	13	11	9	7
A3. Permanently lower GDP growth 1/	25	24	28	18	13	11	9	8
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	25	24	29	19	14	11	10	8
B2. Primary balance is at historical average minus one standard deviations in 2015-201	25	24	28	18	13	11	10	6
B3. Combination of B1-B2 using one half standard deviation shocks	25	24	28	19	13	11	10	7
B4. One-time 30 percent real depreciation in 2015	25	26	34	21	15	12	11	7
B5. 10 percent of GDP increase in other debt-creating flows in 2015	25	24	29	18	13	11	10	6

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

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Table 4a. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34

(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of debt-to GDP ratio								
Baseline	32	28	25	20	19	18	14	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	32	33	34	31	31	32	36	35
A2. New public sector loans on less favorable terms in 2014-2034 2	32	27	24	23	23	23	21	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	32	29	26	21	19	18	14	7
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	32	30	30	25	22	22	17	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	32	35	38	31	27	27	21	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	32	30	28	23	21	20	15	6
B5. Combination of B1-B4 using one-half standard deviation shocks	32	35	42	35	32	31	24	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	32	39	34	28	25	24	18	8
PV of debt-to-exports ratio								
Baseline	79	75	71	60	54	51	39	17
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	79	87	94	90	89	90	99	97
A2. New public sector loans on less favorable terms in 2014-2034 2	79	73	67	67	66	64	57	36
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	79	75	69	60	52	50	37	17
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	79	85	100	89	79	75	55	22
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	79	75	69	60	52	50	37	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	79	80	78	69	61	58	43	18
B5. Combination of B1-B4 using one-half standard deviation shocks	79	80	88	78	70	66	48	19
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	79	75	69	60	52	50	37	17
PV of debt-to-revenue ratio								
Baseline	120	106	93	71	67	64	49	22
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	120	124	124	107	111	114	124	125
A2. New public sector loans on less favorable terms in 2014-2034 2	120	104	88	79	82	81	72	47
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	120	109	96	74	69	66	50	23
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	120	112	109	87	82	78	58	24
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	120	132	139	108	100	96	72	34
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	120	113	103	81	76	73	54	23
B5. Combination of B1-B4 using one-half standard deviation shocks	120	134	155	124	116	111	82	33
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	120	146	124	97	89	86	64	30

Table 4b. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34 (continued)

(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
Debt service-to-exports ratio								
Baseline	5	8	13	8	4	3	3	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	5	9	16	11	6	4	6	8
A2. New public sector loans on less favorable terms in 2014-2034 2	5	8	4	4	4	3	4	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	5	8	13	8	4	3	3	2
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	5	9	16	10	5	4	5	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	5	8	13	8	4	3	3	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	5	8	13	8	4	3	4	2
B5. Combination of B1-B4 using one-half standard deviation shocks	5	8	14	9	4	3	5	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	5	8	13	8	4	3	3	2
Debt service-to-revenue ratio								
Baseline	7	11	17	10	5	4	4	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	7	12	21	13	7	6	8	11
A2. New public sector loans on less favorable terms in 2014-2034 2	7	11	6	5	5	4	4	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	7	12	18	10	5	4	4	3
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	7	11	17	10	5	4	5	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	7	14	27	15	8	6	7	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	7	11	17	10	5	4	5	3
B5. Combination of B1-B4 using one-half standard deviation shocks	7	13	24	14	7	6	8	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	7	16	24	13	7	5	6	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	37	37	37	37	37	37	37	37

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

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assu an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

INTERNATIONAL MONETARY FUND

MALAWI

March 5, 2015

FIFTH AND SIXTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR WAIVERS FOR NON-OBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, MODIFICATION OF PERFORMANCE CRITERION, AND REPHASING OF DISBURSEMENTS—INFORMATIONAL ANNEX

Prepared By

The African Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of December 31, 2014)

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	6.55	9.86

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ESF Arrangements	27.76	40.00
ECF Arrangements	93.97	135.41

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF	07/23/2012	07/22/2015	104.10	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.

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	17.35	17.86	15.71	20.41	11.89
Charges/Interest	0.03	0.03	0.06	0.04	0.14
Total	17.38	17.89	15.77	20.45	12.03

[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 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 2006 the Fund determined that Malawi maintains a multiple currency practice (MCP) inconsistent with Article VIII, Section 3, due to a spread of more than 2% between the exchange rates of commercial banks and the rates of foreign exchange bureaus. At that time, the Fund determined that the spread resulted from official action by RBM, through informal limitation on the availability of foreign exchange and moral suasion on commercial banks.

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 473.7 per U.S. dollar at end-December 2014. Official actions continue to play a role in influencing the exchange rate, but the exchange rate movements are largely market determined. Therefore, the de jure (as well as de facto) exchange rate arrangement was reclassified to floating from other managed arrangement.

Article IV Consultation:

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

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

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

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
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
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

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
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
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

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
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
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

(January 12, 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. MW-DRM	On-going	October, 2016
	2. Malawi Capacity Procurement Building	On-going	October, 2015
	3. MW - Gender Policy Notes	February, 2015	March, 2015
	4. Malawi Policy Note Series	On-going	February 2015
	5. Malawi Primary Education PET-QSD study	February, 2015	April, 2015
	6. Malawi Urbanization Review	January, 2015	March 2015
	7. Renewable Energy Resource Mapping	On-going	September, 2017
	9. Growth and Competitiveness	January, 2015	December 2015
	10. Malawi Economic Monitor (MEM)	Dec '14/Jun '15	Jan/Jul 2015
	Lending:		
	1. Ag. Commercialization & Rural Growth	April 2015	September, 2015
	2. Malawi: EITI Implementation Support	May, 2015	July, 2015
	3. MW: Shire Valley Irrigation Project.	August 2015	December 2015
	4. Project to Improve Public Finance and Economic Management	August, 2015	February 2016
	5. Fiscal Management Development Policy Operation	Ongoing	October 2015
IMF work program in next 12 months	1. Fifth review of ECF-supported program	February 2014	April 2014
	2. Sixth review of ECF-supported program	July/Aug 2014	October 2014
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 macro 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)	December 2014	Feb/March, 2015

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of December 31, 2014)

AfDB operations in Malawi date back to 1969. The Malawi Field Office was opened in 2007 and officially launched in July 2008 by AfDB President Dr. Donald Kaberuka. As at December 31, 2014, the Bank had provided significant and diversified support to Malawi, with cumulative commitments worth UA 852.8 million (about US$ 1.3 billion) to finance 100 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) 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, which is 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, the Bank has scaled-up support to regional infrastructure to deepen the country's integration with its neighbors. Accordingly, more than 50 percent of the indicative lending operations are regional and will be financed with ADF, XIII and XIV resources. The Bank will also support Public Private Partnerships (PPPs) in infrastructure development. The CSP mid- term review will be undertaken in 2015.

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$ 40 million). The Bank designed a Restoration of Fiscal Stability and Social Protection (RFSSP) program whose objective is to contribute to restoring fiscal stability and enhancing public finance management in Malawi, as well as support social protection measures to mitigate the adverse social impact of the devaluation of the Kwacha and the increases in fuel and electricity prices. In order to support this agenda, the RFSSP has two components: (i) strengthened PFM transparency and accountability, and (ii) strengthened social protection system. The Bank disbursed UA 4 million (US$ 6 million) as additional budgetary support in June 2013. The Bank has completed appraisal of the Protection of Basic Services Program of US $ 30 million, which is expected to be presented for Board approval, the first quarter of 2015. This Sector Budget Support program is designed to protect critical expenditures in health, education and social protection and improve accountability following suspension of general budget support.

Box. AfDB Ongoing Operations.

The Bank's ongoing operations comprise the following: three projects in the agriculture sector: (i) Agriculture Infrastructure Support Project (AISP); (ii) Small-holder Irrigation and Value Addition Project and (iii) Climate Adaptation for Rural Livelihoods and Agriculture Project (grant from Global Environment Facility). The Bank is also financing through the African Water Facility (AWF) grants the Water Sector Monitoring & Evaluation Strengthening Project and the Water and Sanitation Access project for the Urban Poor in the City of Blantyre which is aimed at improving access to improved water supply and sanitation services. There are currently three projects providing support to the social sector and for economic empowerment (i) the 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 to Information and Communication Technology (ICT). In the transport sector the Bank is supporting the Trunk Roads Rehabilitation Project which includes Blantyre-Zomba road rehabilitation project (60 km) and the Lilongwe Bypass construction Project (13km) as part of the Multinational Nacala Road Corridor. As at the end of December 2014, the overall portfolio was rated satisfactory with an average disbursement rate of 29% In line with the CSP indicative program, the Bank approved four new operations in 2013, the Mzuzu-Nkhata Bay Road Rehabilitation Project (US$ 33.20m), Smallholder Irrigation and Value Addition Project (US$39.98m) funded by Global Agriculture and Food Security Project and the African Development Fund, the multinational Nacala Road Corridor Development Project Phase IV (US$65.9m) and the Public Finance Management Institutional Support Project (about US $ 4.5 million). The PFM Project, which the Board approved in October, 2013, is supporting the Government of Malawi in implementing its five-year Public Finance and Economic Management Reform Program (PFEMRP) through improved tax administration and procurement systems. In April, 2014, the Board also approved Phase II of the National Water Development Programme (about US $ 35 million).

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. During 2012–2013 the Bank prepared a Private Sector Profile for Malawi and has also financed jointly with the World Bank and other partners a Public Expenditure Review. 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 February 2015
I. Assessment of Data Adequacy for Surveillance
General: Although economic data provision has some shortcomings, it is broadly adequate for surveillance.
National Accounts: National accounts estimates are produced with a two-year lag due to untimely source data. However, progress has occurred on improving methodology, in collaboration with a Norway-funded project. East AFRTAC has been assisting with the development of quarterly national accounts, including improvements to a monthly index of industrial production. Staff resources remain insufficient
Price Statistics: A consumer price index (CPI) is available on a timely basis. The CPI base is 2012, drawing on the 2010/11 Integrated Household Survey; and data (on urban and rural price indices) are collected on a monthly basis by regional price collectors. A 2013 East AFRTAC TA mission began the development of import and export price indexes (for which additional resources are needed) and a review of the new producer price index.
Government Finance Statistics: The accuracy and reliability of the data are affected by inadequate source data. A key shortcoming in this area is inadequate system of recording source data. In addition, there are serious quality problems, including data discrepancies, that complicate program monitoring: • While tax revenue data are received in a timely fashion, it is not always possible to reconcile them with deposits in the Malawi Government (MG) Account. • Nontax revenue, including capital revenues collected by line ministries are not properly accounted for in the fiscal reports prepared by the Ministry of Finance. • Data on recurrent expenditure suffer from shortcomings partly related to insufficient bank reconciliation between expenses records prepared by line ministries and financing information prepared by the Ministry of Finance. Line ministries submit spending reports to the Ministry of Finance based on recorded expenses, while the Ministry of Finance estimates expenses based on funding data (from the Credit Ceiling Authority). At times, there are sizable discrepancies between these two sources of data for both wages and other recurrent transactions—to some extent reflecting the widespread practice of reallocation across budget lines. • Domestically financed development expenditure estimates are based on funding released to line ministries, and estimates on externally funded expenditure are based on reported project grants and loans. Owing to differences in timing and financing modalities (e.g., some donors require pre-financing of expenditure before reimbursement), there are substantial differences between the flow of expenses and corresponding financing data. In addition, many donor projects are still not incorporated in the budget, and hence the corresponding expenditure is not captured in government finance statistics. Some externally funded development expenditures are likely recurrent and reported capital expenditure therefore overstated.

- Data on expenditure arrears are likely incomplete, as reporting from the Commitment Control System appears to be only partial, and ministry level data are not consistent from report to report.

- Malawi's current budget classification includes economic and program classification and program, but does not include an effective administrative/organizational classification.[1] Expenditure data is loosely mapped to functional classification based on the classification of functions of government (CoFoG) classification.

- The budget classification and chart of accounts may be adequate for some administrative, economic, functional, and program classifications. An output-oriented activities-based budget classification (ABB) is used for the presentation of the budget. However, pro-poor expenditures that have been protected in line with the PRSP are only identified in the ABB classification. As no bridge table exists to map the ABB classification into the program classification used for expenditure reporting and accounting, pro-poor expenditures cannot be monitored. Under the ECF program, the government is expected to develop a mechanism for properly monitoring social expenditures.

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

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

- Financing estimates are based on monetary and debt data, rather than on government records of financing. Reporting on treasury bills directly issued to the RBM at times has been slow.

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

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

- A GFS TA mission visited Lilongwe in June 2011 in the context of the country's participation in the GFS Module under the Enhanced Data Dissemination Initiative funded by DFID. It found that annual and sub-annual data for budgetary central government are compiled in *GFSM 1986* format of the Ministry of Finance, but are not disseminated. A new chart of accounts aligned with the *GFSM 2001* was introduced in the 2011–12 budget cycle, which applies to all general government units. A number of source data issues were identified and recommendations made to address them. Bridge tables linking the national classifications and *GFSM 2001* classifications were prepared by the mission, and should be revised and used to compile GFS in *GFSM 2001* format. A follow up mission is included in the RAP for FY 2015. Government finance data are reported for publication in the *Government Finance Statistics Yearbook (GFSY).*

Monetary and Financial Statistics: The Reserve Bank of Malawi (RBM) has improved data reporting to the Fund. Monthly monetary and financial statistics (MFS) are reported to STA on a continuous basis. The 2013 and 2015 missions assisted RBM staff in developing the standardized report forms (SRFs) for the central bank accounts (1SR), other depository corporations (2SR), monetary aggregates (5SR), and financial soundness indicators (FSIs). The authorities are expected to begin reporting SRF-based MFS and FSI data to STA by end-2015.

The quality of the reported data has been improved. The RBM has revamped banks' call report forms to include additional breakdowns of assets and liabilities by institutional sector. Repurchase agreements data that were originally reported in the ODCs balance sheet without any breakdowns by holding sector are now reported in a separate annex, which provides the necessary breakdowns of the holding sectors. Similarly, the annex on overdue and nonaccrual loans, leases, and other assets by sector, which was previously reported on a quarterly basis, is now reported on a monthly basis.

Despite this progress, MFS data are still in need of improvements in terms of financial institution coverage. The depository corporation survey (DCS) does not include data for one investment bank which accepts deposits included in broad money, thereby hampering the accuracy of the compiled data. The 2013 and 2015 missions recommended the inclusion of that bank in the DCS. These missions also recommended inclusion in the DCS of saving and credit cooperatives (SACCOs) and their parent body—Malawi Union of Saving and Credit Cooperatives (MUSCCO).

Financial sector surveillance: With regard to FSIs, Malawi currently does not report data to the Fund for dissemination on the Fund website.

External sector statistics: The balance of payments (BOP) statistics in Malawi are compiled by the Balance of Payments Section of the NSO and are prepared in close coordination with the Malawi National Accounts (NA). The estimates are largely based on survey data for private enterprises, trade statistics, banking data, and information from Government Departments. Some of the surveys collect balance of payments and NA data together. Malawi reports the BOP and IIP in the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* format, reasonably compliant.

The BOP Section collects data via three substantial surveys. The Foreign Private Capital (FPC) survey collects data, essentially for the financial account; the BOP survey collects services and primary income data; and the Non-Profit Institutions Serving Households (NPISH) survey collects secondary income and capital account data. The achievement of the recommendations of the last TA missions (April 2012, November 2012, November 2013, and February 2014) depends on the maintenance of the funding and resources available to the BOP Section. The likely Government budget constraints over the coming years may make funding difficult to achieve. The constraints, especially after the Malawi "Cashgate" scandal, are severe. The funding for the 2015 FPC survey (data for 2013 and 2014) has been agreed for this Spring/Summer, while there was no funding for the BOP and NPISH surveys in 2014.

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.

Malawi: Tables of Common Indicators Required for Surveillance

(As of January, 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]	10/2014	01/2015	M	M	M		
Reserve/Base Money	10/2014	01/2015	M	M	M	LO, LO, LNO, O	LO, O, O, O, O
Broad Money	10/2014	01/2015	M	M	M		
Central Bank Balance Sheet	10/2014	01/2015	M	M	M		
Consolidated Balance Sheet of the Banking System	10/2014	01/2015	M	M	M		
Interest Rates[2]	12/2014	01/2015	M	M	M		
Consumer Price Index	12/2014	01/2015	M	M	M	O, LNO, O, O	LNO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	10/2014	11/2014	M	M	I	O, LO, O, O	O, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	10/2014	11/2014	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	10/2014	11/2014	M	M	M		
External Current Account Balance	10/2014	11/2014	A	A	A	O, O, O, O	LO, O, LO, O, O
Exports and Imports of Goods and Services	10/2014	11/2014	A	A	A		
GDP/GNP	10/2014	11/2014	A	A	A	LO, LNO, LNO, LO	LNO, LNO, LO, LO, LNO
Gross External Debt	2014	11/2014	M	I	I		
International Investment Position[6]	2010	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 discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign and 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.

Press Release No. 15/133
FOR IMMEDIATE RELEASE
March 23, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth and Sixth Reviews under Malawi's ECF Arrangement, and Approves US$ 18.1 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth and sixth reviews of Malawi's economic performance under the program supported by an Extended Credit Facility (ECF) arrangement.[1] The Board's decision enables the immediate disbursement of SDR 13.02 million (about US$18.1 million), bringing total disbursements under the arrangement to SDR 65.08 million (about US$ 90.3 million).

In completing the fifth and sixth reviews, the Executive Board also approved the authorities' request for waivers of non-observance of performance criteria related to the net domestic assets of the Reserve Bank of Malawi (RBM), net domestic borrowing by the government, the ceiling on new non-concessional external debt maturing in more than one year, and the ceiling on non-accumulation of external payments arrears.

The Board also approved a request for an extension of the current ECF arrangement by six months to May 22, 2016 and the rephasing of disbursements associated with the seventh and eighth reviews.

The three-year ECF arrangement for Malawi in the total amount of SDR 104.1 million (about US$ 144.4 million) was approved on July 23, 2012 (see Press Release No. 12/273).

At the conclusion of the Executive Board's discussion, Mr. Mitsuhiro Furusawa, Acting Chair and Deputy Managing Director, issued the following statement:

"Malawi's macroeconomic outlook and performance under the IMF-supported program was significantly damaged by a large-scale theft of public funds and by policy lapses in the run-up to elections. The breach of governance resulted in the suspension of budget support from

[1] The Extended Credit Facility (ECF) is the IMF's main tool for medium-term financial support to low-income countries. It provides for a higher level of access to financing, more concessional terms, enhanced flexibility in program design, and more focused, streamlined conditionality. Financing under ECF currently carries a zero interest rate, with a grace period of 5½ years, and a final maturity of 10 years.

donors, which has led to increased recourse to central bank financing, accumulation of domestic arrears, exchange rate depreciation, and high inflation.

"The new government is committed to rebuilding trust in public institutions and bringing the IMF-supported program back on track, including through maintaining a flexible exchange rate regime and the automatic fuel pricing mechanism. Bringing inflation down to single digits and boosting official foreign exchange reserves remain key policy objectives.

"Addressing weaknesses in public financial management is necessary to restore confidence in the budget process and foster donor re-engagement. The authorities' steadfast implementation of a comprehensive strategy in this area remains an urgent policy priority.

"The central bank is committed to tightening monetary policy as needed to keep inflation on a downward path. Measures taken in late 2014 have already helped reduce liquidity and stabilize the currency. Steps underway to curb deficit financing by the central bank should enhance the credibility of monetary policy.

"Improved prudential and regulatory frameworks are key to safeguarding financial sector stability and supporting growth. The recently-completed diagnostic assessments of the banking system will be used to design a strategy to address sector-wide issues.

"Nonconcessional external borrowing in October 2013 gave rise to noncomplying disbursements following the completion of the third and fourth reviews of the Fund-supported program in January 2014. The authorities have taken corrective actions to strengthen their monitoring of the concessionality of new external loans and to enhance communication with Fund staff on this matter. In view of the corrective actions taken by the authorities, the Board decided to waive the nonobservance of the performance criteria that gave rise to the noncomplying disbursements."

Statement by Mr. Mkwezalamba, Alternate Executive Director, Mr. Tucker, Senior Advisor to the Executive Director and Mr. Sitimawina, Advisor to the Executive Director for Malawi, March 23, 2015

Introduction

1. The Malawian authorities appreciate the meaningful policy advice and guidance of the Fund Executive Board and Management in their efforts to achieve macroeconomic stability, reduce poverty and attain sustainable and inclusive growth. Further, they welcome and commend the constructive policy dialogue with staff during the program discussions.

2. The elections of May 2014 ushered in a new government of Prof. Arthur Peter Mutharika, which is firmly committed to the objectives of ECF supported program, including vigorously pursuing the implementation of the recommendations of the forensic audit report, strengthening PFM systems, and implementing critical structural reforms. Their commitment is manifested through their efforts to stabilize the macroeconomic situation and the continued implementation of various reforms. Most of these reforms have been covered in the staff report and we will emphasize on some of them in our statement. It is against this backdrop that the authorities solicit the Executive Directors' support for their request for completion of the fifth and sixth reviews under the ECF arrangement, the request for waivers for non-observance of performance criteria, extension of the arrangement, modification of performance criterion and the re-phasing of disbursements.

Performance under the ECF arrangement

3. The uncovering in late 2013 of the misappropriation of public funds, referred to in Malawi as 'cashgate', disrupted the progress towards macroeconomic stabilization and structural transformation of the Malawian economy. The authorities' response to the 'cashgate' scandal was swift and robust. Immediately, a forensic audit of the suspected transactions was launched and action to address weaknesses in public financial management (PFM) was initiated. In this regard, prosecutions arising from the audit report are being pursued resulting in convictions and recovery of some assets.

4. However, the ensuing suspension of budget support by development partners exacerbated the economic situation, rendering budget execution and implementation of the Extended Credit Facility (ECF) program challenging. Attempts by the authorities at fiscal adjustments in response to this development proved ineffective, as the programmed domestic borrowing ceiling was breached and large domestic payment arrears accumulated. The pace of reserves accumulation slowed and efforts at managing domestic liquidity was constrained. Consequently, as highlighted in the staff report, several quantitative performance criteria (PCs) in respect of the fifth and sixth program reviews—end-December 2013 and end-June 2014 test dates, respectively—were missed. On the structural reform agenda, some delays in implementation were experienced, though key measures, including verification of the stock of government domestic arrears and third party diagnostics of commercial banks, were implemented.

5. In spite of the challenges, the Malawian authorities have remained committed to implementing sound macroeconomic and structural policies, and returning the program on track. This has been manifested in the attainment of all but one of the informal quantitative targets agreed with the staff team on Net Domestic Assets, Net Domestic Financing and gross official reserves for end-September 2014 and end-January 2015. More importantly, the prior actions agreed upon for completion of the fifth and sixth reviews under the program, in the areas of fiscal policy, public financial management, monetary policy and financial sector, have been fully implemented.

6. The authorities underscore their determination to prevent the recurrence of the breach of the continuous PC on new non-concessional external debt maturing in more than one year and the continuous PC on the non-accumulation of external payment arrears. As expressed in the authorities' response to the Managing Director's letter on the subject and in their Letter of Intent, appropriate remedial measures have been undertaken. These include cancellation and replacement of the Supplier's Credit Agreement with a suppliers' agreement with a much reduced total value of the overall transaction of only US$33 million from US$145.3 million and normalization of all outstanding external payment arrears. In addition, debt management capacity is being enhanced following the resuscitation of the Debt Management Committee. The authorities have also made an undertaking to share with Fund staff all new loan proposals to ensure conformity with program understandings. Against the backdrop of these measures, our authorities request waivers for non-compliance with the missed continuous PCs.

Recent economic developments, macroeconomic outlook and policies

7. The medium-term macroeconomic outlook remains favorable, with policies focused on strengthening the macroeconomic position and sustaining growth on its upward trajectory. Consistent with this outlook, the authorities' short-term priorities will be on restoring macroeconomic stability, reinforcing PFM systems, and preserving the stability of the financial sector. Economic growth is expected to be somewhat resilient on account of increased public investment in infrastructure and an improved policy and business environment. Inflation is to decline from current levels to low double digits by end-2015 and then single digit levels towards end-2016, benefiting from a well-calibrated monetary policy and lower international fuel prices.

8. While real GDP is projected to have grown by around 6 percent in 2014 driven by agriculture, wholesale and retail trade, and information and communication sector, the outlook in 2015 could be affected the by heavy downpour of torrential rains and subsequent worst floods Malawi has suffered in its history. The floods have affected 15 of the 28 districts in the country, causing severe toll in human lives and destroying crucial transport infrastructure and disrupting energy generation. Over 172 people are missing while 106 have died. In addition, livestock, houses and a significant portion of agricultural land have also been destroyed. This will affect growth in the agricultural sector and may in turn affect food security in the next consumption year, with undesirable implications for public finances. This development poses immense risks to the realization of the envisaged near-term growth and inflation outlook. The authorities express their appreciation to the international community for their rapid response to the disaster and their continued support which is helping to alleviate the plight of those affected.

Fiscal and debt management policies

9. In spite of the difficult domestic fiscal environment, the authorities remain committed to pursuing prudent fiscal policy geared towards consolidating the fiscal position while avoiding a further build-up of domestic payment arrears. The current FY2014/15 budget is predicated on large fiscal adjustments, with significant reduction in non-statutory recurrent expenditures and domestically financed capital spending against the backdrop of the dearth of external budgetary support and the constrained space for domestic bank financing. While this has been challenging, the authorities continue to exercise fiscal discipline by restraining budget execution within program limits. Going forward, efforts will continue to strengthen fiscal management and shore up public finances. On the revenue front, policy measures will focus on strengthening tax administration and minimizing tax exemptions. On expenditures, the authorities will seek to further rationalize the budget envelope while preserving allocations to growth-enhancing sectors. Regularizing the large stock of domestic arrears accumulated over the years remains a priority over the medium term. To this end, the authorities are determined to proceed with clearing all audited and verified domestic arrears through cash payments and the issuance of 'zero coupon bonds' over the next three fiscal years.

10. The authorities reiterate their commitment to preserving debt sustainability over the medium to long term. While the country remains at a moderate risk of external debt distress, as assessed by the staffs' debt sustainability analysis, they are mindful of the heightened overall risk of debt distress resulting from the increasing vulnerabilities from domestic debt accumulation. Thus, in addition to the measures highlighted above to strengthen debt management and prevent the incidence of misreporting, they will continue to exercise fiscal restraint while relying mostly on concessional external borrowing to finance critical development projects.

Public financial management

11. A centerpiece of the authorities' near-term reform agenda is the strengthening of public financial management systems to facilitate efficient government financial operations and restore public confidence in budget execution. In this regard, the authorities commend the TA that has been received from FAD. Already, significant progress has been accomplished in strengthening commitment controls, reconciling fiscal accounts, and improving cash management. Further consolidation of these efforts will be sought through judicious implementation of the recently adopted PFM strategy, within the framework of the authorities' Public Finance and Economic Management Reform Programme. In view of the several operational and system deficiencies in the current Integrated Financial Management Information Systems (IFMIS), the authorities have initiated the process of procuring a new, well secured and efficient IFMIS. In the interim, the current system is being enhanced to ensure that efficient government financial transactions continue while prosecutions of the alleged cases of fraud identified in the Forensic Audit report are resolutely being pursued. Subsequently, an assessment of the implementation of these recommendations will be undertaken by a reputable international audit firm.

Monetary and exchange rate policies

12. The Reserve Bank of Malawi (RBM) has demonstrated a strong commitment to stabilizing monetary conditions and bolstering the external reserves position, using monetary policy instruments at its disposal. In response to increased inflationary pressures and a sharp depreciation of the Kwacha in 2014, the Bank raised the policy rate by 250 basis points and increased the liquidity reserve requirement on foreign currency deposits with commercial banks. Further, a 'currency swap' arrangement was implemented involving the purchase of government debt denominated in Kwacha by a foreign commercial bank, the Preferential Trade Area (PTA) Bank, using US dollars. These policy actions culminated in a tightening of monetary conditions through a rise in both the interbank and the treasury bills rate, restoration of some order in the foreign exchange market, and the strengthening of the foreign exchange reserves position. Important steps have also been taken to address the perennial problem of fiscal dominance, including amendments to the RBM Act that impose tighter limit on total government borrowing from the central bank, and the prohibition of the automatic conversion of overdrafts into government securities.

13. Over the near term, the RBM will maintain a tight monetary policy stance to return inflation to a downward path and to appropriately anchor inflation expectations. To this end, the Bank's liquidity forecasting and management framework will be further strengthened to closely monitor the build-up of excess liquidity in the banking system. The current flexible exchange rate regime will be maintained, as it has served the economy well especially in facilitating economic adjustments to exogenous shocks. The RBM will, nonetheless, continue limited interventions in the foreign exchange market to smoothing short-term volatility in the exchange rate and bolster the foreign reserves position.

Financial sector policies

14. The authorities remain committed to taking appropriate steps to address any risks posed by weaknesses in the financial sector. This far, third party diagnostic assessments have been conducted on the banking system, and a restructuring process to resolving issues with two banks identified as weak has commenced. A comprehensive strategy is being developed to address banking sector-wide problems from the assessments. In addition, migration to Basel II Core Principles has been completed, with an increase in total capital requirement ratios of banks. A prompt corrective action framework to strengthen and clarify existing triggers for early remedial action against distressed banks has been adopted. The RBM will continue efforts to strengthen the supervisory and regulatory frameworks of the banking system. On-site inspection and off-site supervision will be intensified, compliance with prudential norms strictly enforced, and loan concentrations closely monitored. Further, the enactment of amendments to the Banking and Financial Services Acts to ensure consistency with international best practices in bank resolution will be pursued.

Request for waiver of non-observance of performance criteria

15. The Malawi authorities deeply regret the misreporting associated with the third and fourth reviews and request a waiver for non-observance of a performance criterion (PC) under the ECF supported program. As explained in EBS/15/13, the misreporting relates to the nonobservance of

the continuous PCs on new non concessional external debt maturing in more than one year and external payments arrears.

16. In line with the Managing Directors report, the Malawi authorities did not, at the completion of the third and fourth reviews, report to the Fund that it had not contracted new non-concessional external loans after the completion of the second review on April 8, 2013, aside from a non-concessional loan with China for which a waiver was requested, and that it had accumulated no external arrears during the review period. The reported observance of the external payments arrears PC, as well as the corrective actions taken by the authorities to address the non-observance of the non-concessional external debt PC at that time formed part of the basis for the Executive Board's completion of the third and fourth reviews. As it turned out, the information provided by the authorities, was inaccurate, leading to non-complying disbursements.

17. The new administration recognized that the terms of the Supply Credit Agreement run counter to the understanding of the ECF arrangement and immediately took corrective measures. The measures which are outlined in the authorities' response of February 19, 2015 to the Managing Director's letter of February 12, 2015, (EBS/15/13), include cancellation and replacement of the Supplier's Credit Agreement with a suppliers' agreement with a much reduced total value of the overall transaction and normalization of all outstanding external payment arrears. In addition, debt management capacity is being enhanced following the resuscitation of the Debt Management Committee. The authorities have also made an undertaking to share with Fund staff all new loan proposals to ensure conformity with program understandings.

Conclusion

18. The authorities reiterate their commitment to implementing sound macroeconomic policies and far-reaching structural reforms, within the framework of the ECF arrangement. On the basis of the progress accomplished by the Malawian authorities in addressing the weaknesses in public financial management and correcting underlying macroeconomic imbalances, our authorities solicit the Executive Directors' support for their request for completion of the fifth and sixth reviews under the ECF arrangement, the request for waivers for non-observance of performance criteria, extension of the arrangement, modification of performance criterion and the re-phasing of disbursements.