INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/182

MALAWI

June 2016

SEVENTH AND EIGHTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, AUGMENTATION OF ACCESS, MODIFICATION OF PERFORMANCE CRITERION, AND REPHASING OF DISBURSEMENTS—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI

In the context of the Seventh and Eighth Reviews under the Extended Credit Facility Arrangement and Request for Waivers for Nonobservance of Performance Criteria, Extension of the Arrangement, Augmentation of Access, Modification of Performance Criterion, and Rephasing of Disbursements, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 20, 2016, following discussions that ended on March 24, 2016, 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 June 3, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Staff Statement** updating information on recent developments.
- 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.

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 16/295
FOR IMMEDIATE RELEASE
June 20, 2016

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Completes Seventh and Eighth Reviews under Malawi's ECF Arrangement and Approves US$ 76.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the seventh and eighth 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 the equivalent of SDR 54.22 million (about US$ 76.8 million), bringing total disbursements under the arrangement to the equivalent of SDR 119.3 million (about US$ 169.1 million).

In completing the reviews, the Board also approved the authorities' request for an extension of the current ECF arrangement to end December 2016[2] and an augmentation of access by the equivalent of SDR 34.7 million (about US$ 49.2 million or 25 percent of quota). The requested extension would give the authorities more time to achieve the original objectives of the program while the additional financing will help to strengthen the country's response to the El Niño induced drought which has caused a humanitarian crisis. The Board also approved the authorities' request for waivers of non-observance of performance criteria related to net domestic borrowing by the government and net international reserves.

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. Min Zhu, Acting Chair and Deputy Managing Director, issued the following statement:

"The authorities have strengthened macroeconomic policies and stepped up the implementation of structural reforms over the last year to bring the program back on track. Nevertheless, Malawi's macroeconomic situation remains difficult, reflecting weather-related shocks and past

[1] The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems.

[2] A short extension of the arrangement from May 22, 2016 to June 30, 2016 was approved by the Board on May 13, 2016 to give to the authorities time to implement two prior actions for completing the seventh and eighth reviews. See Press Release No. 16/222.

policy slippages, which contributed to persistently high inflation. Real GDP growth declined sharply due to floods and drought in 2015 and is expected to drop further this year owing to the region-wide El Niño-induced drought. A poor maize harvest for a second consecutive year has placed half of the population at risk of food insecurity. Short-term risks that could arise from adverse weather conditions, lower global demand for Malawi's exports, and policy slippages continue to weigh on the outlook.

"The near-term policy mix should center on reducing inflation by combining tight monetary and fiscal policies. To this end, expenditures will have to be limited to available resources and monetary policy should aim at maintaining positive short-term real money market interest rates.

"Accelerating the implementation of public financial management reforms is indispensable to building trust and confidence in the budget process and ensuring control over fiscal operations. Strong commitment controls, routine bank reconciliations, and regular fiscal reporting remain critical to preventing potential misappropriation of public funds and reviving donor re-engagement.

"The pursuit of prudent fiscal policy is critical to safeguarding medium-term fiscal and debt sustainability. Improved revenue mobilization and expenditure efficiency will reduce aid dependency and create fiscal space for social spending in pursuit of Malawi's sustainable development goals.

"Important steps have been taken over the last two years to safeguard and strengthen financial sector stability. Given recent weather-related shocks and the prevalence of credit concentration risks, the authorities are encouraged to consider additional measures, including higher capital requirements, improved credit assessments, higher provisioning, and bank mergers to mitigate risks."

INTERNATIONAL MONETARY FUND

MALAWI

June 3, 2016

SEVENTH AND EIGHTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, AUGMENTATION OF ACCESS, MODIFICATION OF PERFORMANCE CRITERION, AND REPHASING OF DISBURSEMENTS

KEY ISSUES

Malawi's economy has been hit hard by weather-related shocks for a second consecutive year, further weakening growth and worsening food insecurity. Floods and drought during the first part of 2015 placed 2.8 million people at risk of food insecurity. Drought is negatively impacting the economy for a second consecutive year in 2016, affecting, according to preliminary estimates about 8.4 million people (half of the population) and further lowering the growth outlook. Growth is estimated to have declined from 5.7 percent in 2014 to 3 percent in 2015 and is projected to drop further to 2.7 percent this year. The authorities declared a national disaster in April 2016 and requested additional humanitarian assistance from donors. They are also requesting an augmentation of access under the Extended Credit Facility (ECF) (25 percent of quota or SDR 34.7 million) and an extension of the program to end-December 2016.
This extension would permit a rephasing of disbursements to facilitate a ninth review in order achieve the original objectives under the program.

The ECF arrangement is now back on track. For the seventh review end-June 2015 targets on net domestic assets (NDA) and net international reserves of the central bank (RBM) were met, but net domestic financing (NDF) of the government was missed by a large margin. The authorities have since corrected this slippage and for the eighth review, end-December performance criteria (PCs) on NDF and NDA of the RBM were met by large margins. The end-December PC on net international reserves was missed in part because of lower-than-programmed export revenues due to the drought in the region. Good progress was made on implementing financial sector-related structural reforms. Although the implementation of public financial management (PFM) reforms was initially slow, they have picked up momentum. A prior action linked to reporting on arrears was met, however that related to bank reconciliations is pending.

Outlook and risks: The economic outlook remains challenging in light of continued uncertainties related to weather conditions, the continued suspension of external budget support, and the persistence of high inflation. Short-term risks are tilted to the downside as the food crisis continues to weigh on the outlook. Additional risks arise from potential policy slippages as well as weaker global demand which could hurt Malawi's exports. The flexible exchange rate regime and the automatic fuel pricing mechanism would serve as shock absorbers in mitigating adverse global developments.

Policy discussions: Discussions focused on measures to bring the program back on track while responding effectively to the humanitarian crisis. They also encompassed policies to: (i) maintain tight fiscal and monetary policies to reduce inflation; (ii) accelerate the implementation of public financial management (PFM) reforms to establish trust and confidence in the budget process; (iii) ensure medium-term fiscal sustainability through improved revenue mobilization and better allocation of public spending; and (iv) preserve debt sustainability; and (v) safeguard financial sector stability.

Approved By
David Owen (AFR) and Steven Barnett (SPR)

Discussions took place in Lilongwe during March 9–24, 2016 and continued during the Spring Meetings in Washington DC (April 11–17). The mission was led by Mr. Williams (AFR). Other members of the mission team were Messrs. Nsengiyumva and Wu (both AFR), Mr. Gupta (SPR), Mr. Yousefi (FAD), and Mr. Oestreicher (Resident Representative). Mr. Mkwezalamba (OED) participated in the discussions during the last week of the mission. The mission met with his Excellency President Peter Mutharika, Minister of Finance Goodall Gondwe, Reserve Bank of Malawi (RBM) Governor Charles Chuka, other senior government and RBM officials, as well as, representatives of the business community, civil society organizations, and Malawi's international development partners.

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CONTEXT

1. **Malawi's macroeconomic situation remains difficult.** The economy has been hit hard by drought for a second consecutive year, and this has contributed to weak economic activity, and placed almost half of the population at risk of food insecurity. In 2015, donors and the authorities provided relief to 2.8 million people but the situation has worsened as the drought has become more pronounced. The large policy slippages that emerged in 2015 contributed to the persistence of inflation which has remained in double digits since 2012 and continues to pose a challenge to macroeconomic stability.

2. **Progress was made in prosecuting suspects in the "cashgate scandal" (MEFP ¶13).** To date, there have been eleven convictions including that of the main suspect who was charged with embezzling an estimated US$10 million, but asset recovery has been slow.

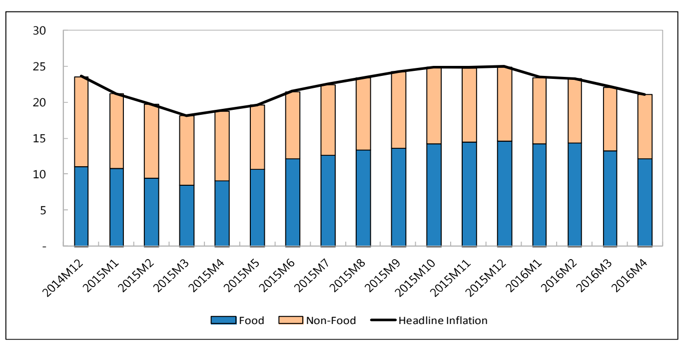
3. **The program went off track due to policy slippages which prevented the completion of the seventh review (end-June 2015 test date).** Both end-June 2015 targets on net domestic assets (NDA) and net international reserves of the central bank (RBM) were met, but net domestic financing (NDF) was missed by a large margin (2 percent of GDP), mainly due to the unplanned recruitment of teachers, unbudgeted wage increases, and revenue shortfalls. All public financial management (PFM)-related structural benchmarks—the centerpiece of the program's structural agenda—were also missed. However, good progress was made in implementing those structural measures related to the financial sector.

RECENT ECONOMIC DEVELOPMENTS

4. **Growth fell sharply in 2015.** Heavy floods in early 2015 followed by drought resulted in an estimated 30 percent decline in the maize harvest which contributed to a drop in real GDP growth to 3 percent (from 5.7 percent in 2014). Real GDP growth in 2016 is expected to drop further to 2.7 percent, based on another poor maize harvest owing to the region-wide El Niño-induced drought.

Text Figure 1. Malawi: Decomposition of Headline Inflation

(Dec. 2014–Apr. 2016)



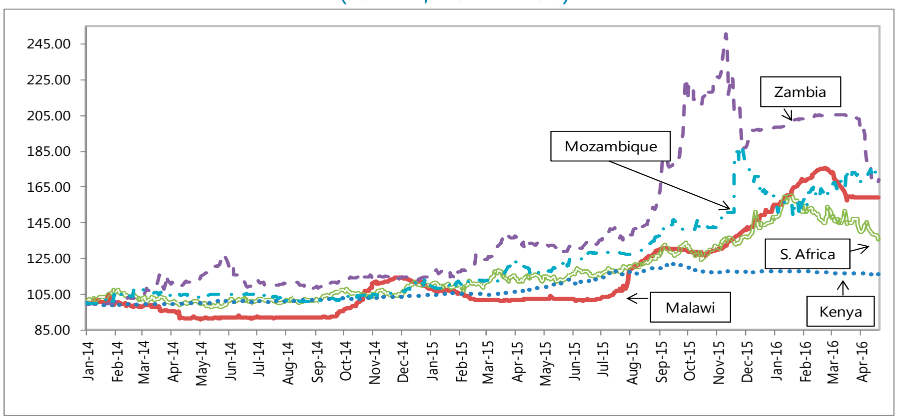
Sources: Malawian authorities and IMF staff estimates.

5. **Inflation rose sharply reflecting the impact of weather-related shocks on agricultural output.** Annual inflation increased from 18 percent in March to 24.9 percent at end-December 2015 led by rising food prices and a sharp depreciation of the kwacha. However, inflation has since fallen to 20.9 percent at end-April 2016— owing to a trend decline in non-food inflation— suggesting that the appropriate adjustments in monetary and fiscal policies are having their intended effects.

6. The exchange rate weakened dramatically from mid-2015, but has now stabilized (Text Figure 2). The kwacha depreciated by close to 36 percent from July 2015 to February 2016, following a similar trend in other regional commodity-dependent countries. The RBM intervened during this period to dampen volatility. Expectations played a role in the depreciation as the ECF arrangement was declared off-track. The exchange rate has started to stabilize since March 2016, reflecting better fiscal discipline, and efforts by the central bank to absorb excess liquidity from the banking system and maintain positive real interest rates.

Text Figure 2. Regional Currencies vs. the U.S. Dollar

(Jan 1st, 2014=100)



Source: IMF staff estimates.

7. Money and credit conditions remained weak. Reserve and broad money growth have been on a declining trend reflecting policy tightening. Broad money and credit to the private sector grew by 14 percent and 18 percent respectively, after adjusting for the valuation effects from the recent depreciation of the kwacha. Growth in real credit has remained negative since mid-2012 due to persistently high inflation, economic uncertainties, and tighter bank lending conditions (Figure 2). The valuation effect also played a significant role in the decline in the ratio of non-performing loans (NPLs) to gross loans in 2015, by 4 percentage points (Table 5).

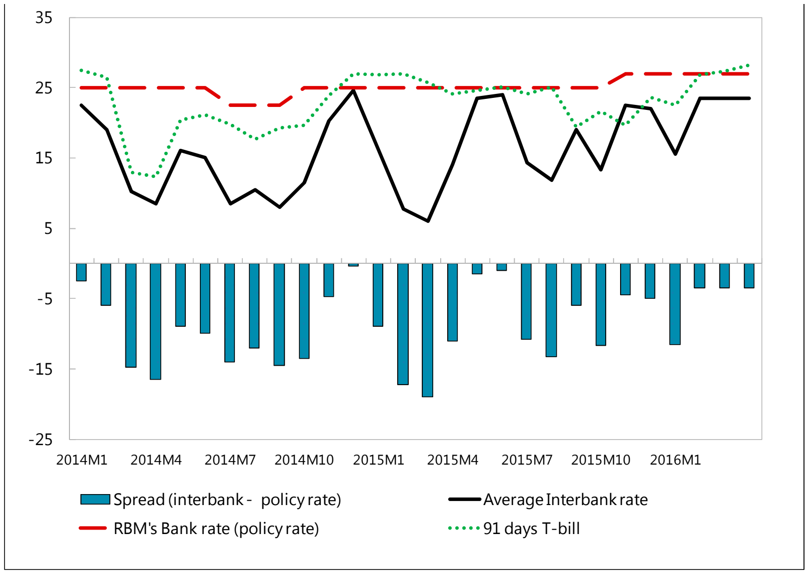
8. The external current account deficit narrowed, partly reflecting weaker demand. The current account deficit is projected to have declined from 8.5 percent of GDP in 2014 to 8.2 percent in 2015. This development in part reflected the effects of weaker aggregate demand on imports, the decline in international oil prices, and higher tobacco export revenues.

9. Budget execution during the first half of FY15/16 remained within the limits fixed under the program. Revenues were broadly in line with the program and spending was restrained. As a result, NDF at end-December was considerably below the program's ceiling, including after accounting for logistical delays in distributing fertilizer subsidies.

10. A relaxation of the stance of monetary policy in mid-2015 was reversed toward the end of the year. Banking system liquidity increased due to the RBM's halving the liquid reserve ratio (LRR) to 7.5 percent in August 2015. However, sterilization efforts since September 2015 and an increase in the policy rate by 200 basis points to 27 percent in early November contributed to reducing excess liquidity and raising interbank and treasury bill rates closer to the policy rate. (Text Figure 3).

Text Figure 3. Policy, Interbank and Treasury Bill Interest Rates

(Jan. 2014–Apr. 2016)



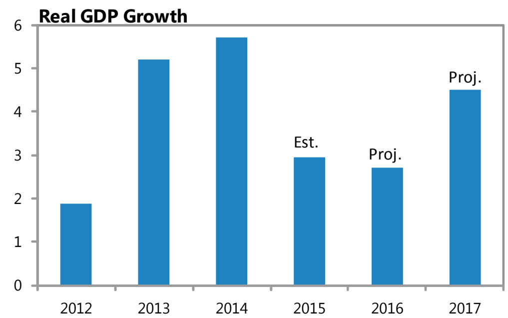
Sources: Malawian authorities and IMF staff estimates.

11. Policy slippages that derailed completion of the seventh review have been corrected. Performance criteria at end-December 2015 for NDA and NDF were met (Table 9a). However, NIR was missed largely due to lower- than-expected export revenues.[1] Some progress was made in implementing PFM reforms, notably in regard to rationalizing government bank accounts at the RBM, enhancing the reliability of the information systems, and the publication of fiscal outturns. However, implementation of key PFM benchmarks—completion of bank reconciliations and reporting of arrears—was delayed. These two PFM benchmarks were subsequently set as prior actions for completion of the seventh and eighth reviews under the ECF arrangement. The prior action on reporting on domestic payment arrears was met. However, the prior action related to bank reconciliations is pending. The wages account which was initially part of the prior action on bank reconciliation has now been set as an end-June benchmark due to technical reasons related to five wage-related platforms that are not interconnected (MEFP, ¶13). The indicative target on pro-poor spending was marginally missed owing to delays in the distribution of fertilizer subsidies.

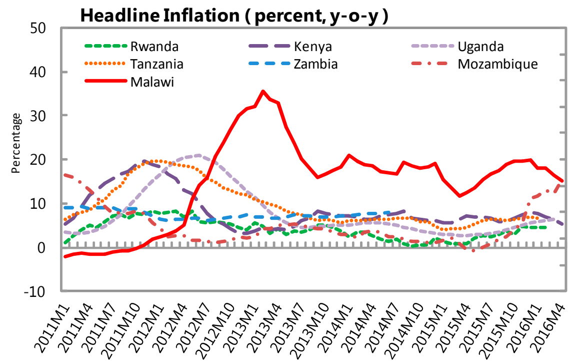
[1] Sugar, tobacco, and nontraditional export prices declined.

Figure 1. Malawi: Recent Economic Developments, 2011–16

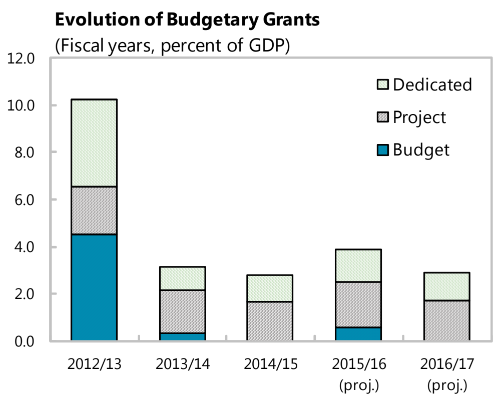
Economic activity continued to be affected by adverse weather since 2015…



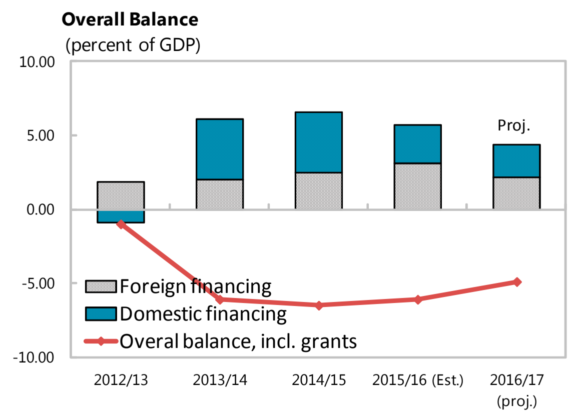
… while headline inflation remains stubbornly high compared to neighboring countries.



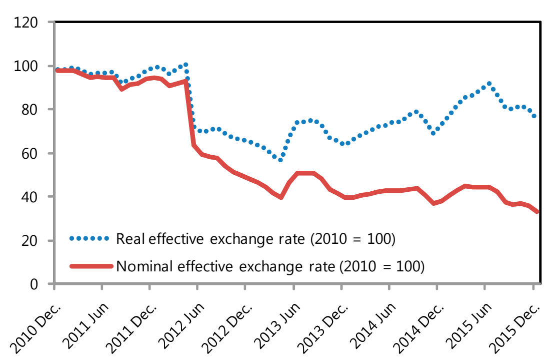
External budgetary assistance has not yet resumed since the public funds misappropriation scandal in 2013/14.



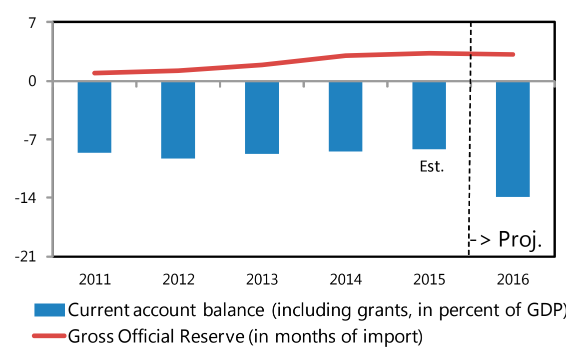
Fiscal adjustment has been insufficient since the cashgate and deficits have been largely covered by domestic financing .



The REER appreciated, reflecting relative higher inflation, but some correction has been taking place in recent months.



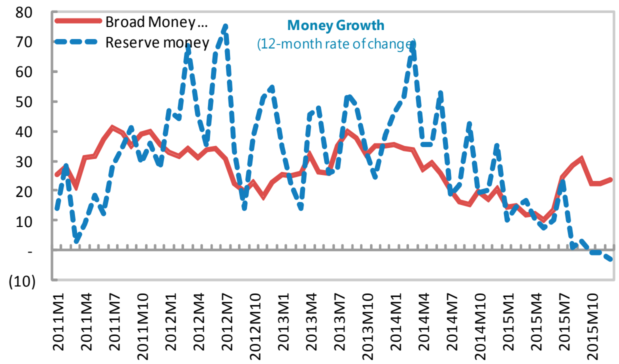
The current account narrowed reflecting weak aggregate demand.



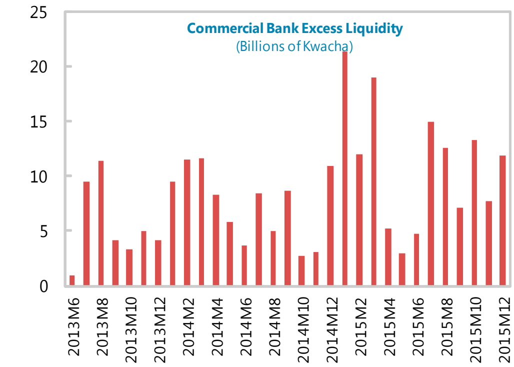
Sources: Malawian authorities and IMF staff estimates.

Figure 2. Malawi: Recent Monetary Developments, 2011–15

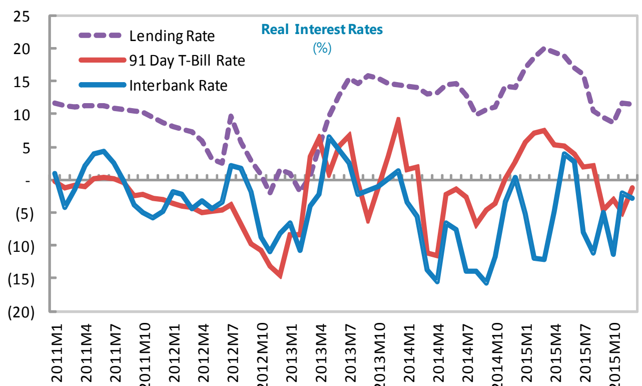
The declining trend of broad money growth was reversed in mid-2015, mostly due to the valuation effect resulting from the depreciation of the Kwacha.



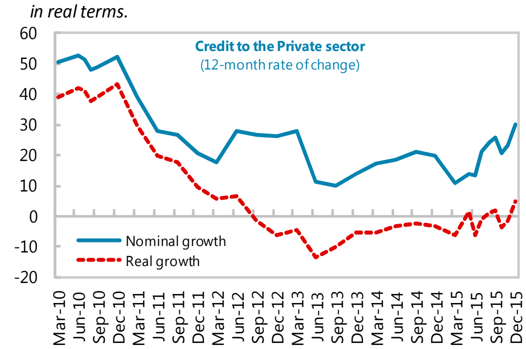
But liquidity management has not been strong enough to prevent persistence of excess liquidity in the banking system.



Average real prime lending rate has remained elevated,

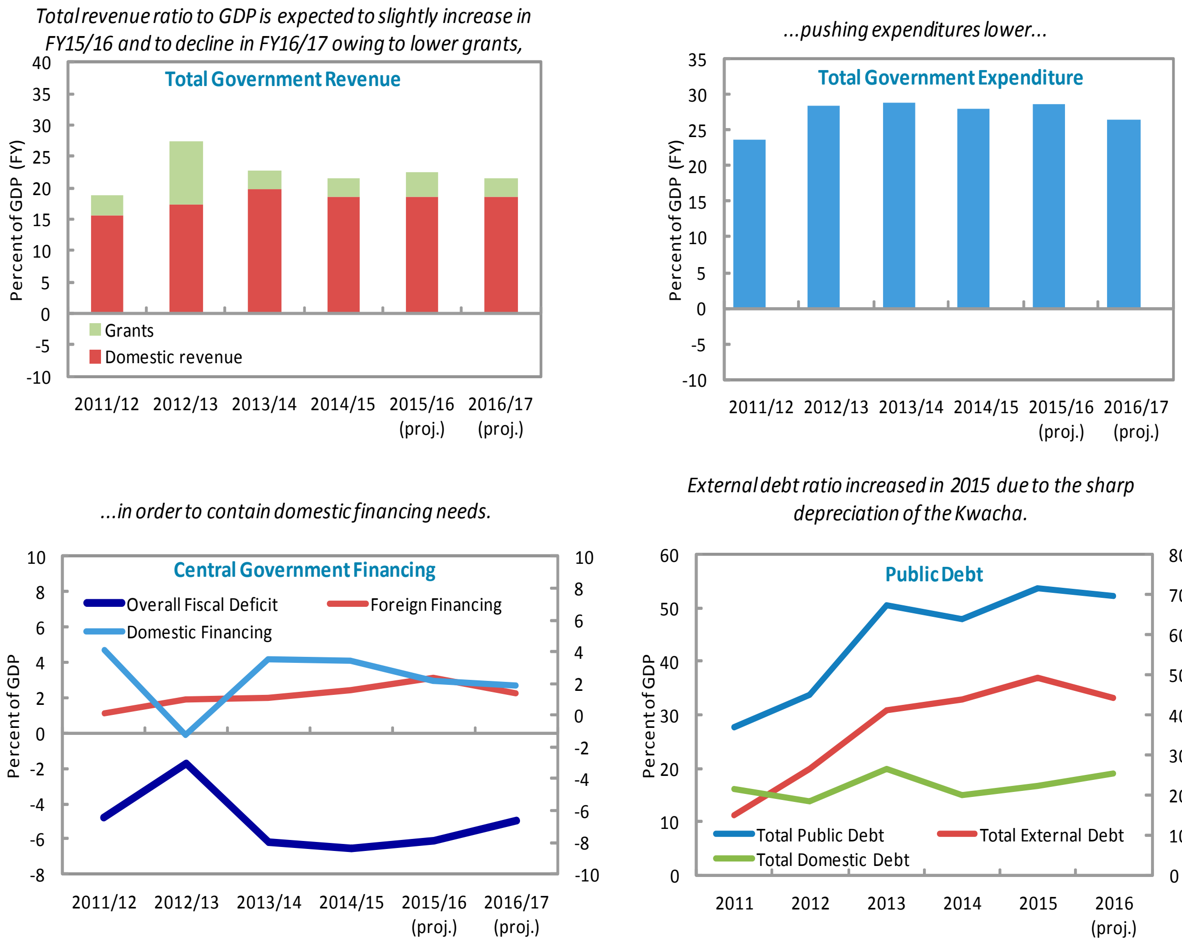


which contributed to lowering credit growth to negative levels in real terms.



Sources: Malawian authorities and IMF staff estimates.

Figure 3. Malawi: Fiscal Developments and Outlook, 2011–17



Sources: Malawian authorities and IMF staff estimates.

ECONOMIC OUTLOOK AND RISKS

12. The economic outlook remains difficult, reflecting uncertainties related to weather conditions and persistently high inflation. Medium-term projections are predicated on policy actions to contain inflation, a normalization of weather conditions, and progress in addressing key supply-side bottlenecks. The retention of the flexible exchange rate regime and the automatic fuel pricing mechanism will continue to serve as shock absorbers.

- **Real GDP Growth** is projected to pick up to 4.5 percent in 2017, conditional on a recovery in the agricultural sector, and to reach rates in the range of 5–5½ percent over the medium. Credit to the private sector is expected to rise as a decline in inflation pushes down lending interest rates and the increase in private sector confidence re-ignites investment spending.

- **Inflation** is expected to decline at a slower pace than previously projected due to the supply-induced shocks to food prices. However, maintenance of tight fiscal and monetary policy stances—including through strict limits on NDF—will keep inflation on a downward trend. Single digit inflation is anticipated by end-2017, facilitated by low international prices for food and fuel products.

- **The external current account** deficit is expected to rise substantially in 2016 owing to higher maize imports (about 13.9 percent of GDP) for humanitarian relief. It is projected to remain in the 7–9 percent of GDP range over the medium term reflecting the slow pace of export diversification, projected decline in the price of tobacco, and the demand for imports associated with developmental projects and population growth.

13. Short-term risks are tilted to the downside due to the prolonged drought, which continues to weigh heavily on the outlook. Additional downside risks could arise from lower global demand for Malawi's exports or continued slippages in macroeconomic policy implementation, which could place further pressure on the kwacha. Moreover, a slower-than-expected disinflation process could trigger further demands for wage increases. Slow implementation of PFM reforms would undermine credibility in the budget and discourage donor re-engagement.

Text Table 1. Macroeconomic Outlook

	2015	2016	2017	2018	2019
	Est.		Proj.		
GDP at constant market prices (percent change)	3.0	2.7	4.5	5.0	5.5
Consumer prices (% change, annual average)	21.9	19.7	14.1	9.4	8.7
Overal fiscal balance (percent of GDP, on a fiscal year basis)	-6.5	-6.1	-5.0	-2.7	-2.6
Credit to the private sector (percent change)	29.9	20.3	18.9	20.3	22.2
Gross official reserves (Months of imports)	3.4	3.2	3.3	3.4	3.6
Current account (percent of GDP)	-8.2	-13.9	-8.8	-8.0	-7.7
Total public debt (percent of GDP)	53.8	52.1	47.1	44.7	42.5

Sources: Malawian authorities and IMF staff estimates.

POLICY DISCUSSIONS

14. Policy discussions focused on near-term program issues and ensuring medium-term fiscal sustainability. Under the program, the macroeconomic framework in the near term will be anchored on a policy mix incorporating a tight monetary stance and a level of domestic fiscal financing consistent with disinflation. Implementation of PFM reforms will remain the core of the reform agenda that is central to re-establishing trust in the budget process and to re-engaging donors.

15. Achieving fiscal sustainability over the medium term is critical for macroeconomic stability and to re-establishing private sector confidence. Against this background, discussions centered on policies to enhance revenue mobilization, reforming the fertilizer subsidy scheme, and strengthening commitment controls to prevent the reemergence of domestic payment arrears that have had in the recent past, sizable spillover effects on the financial system.

16. The authorities reiterated their commitment to correct macroeconomic imbalances and establishing a path to sustainable and inclusive noninflationary growth (MEFP, ¶ 2). Their overriding goals in the near-term are to keep inflation on a declining trajectory, re-establish trust and confidence in the budget process and maintain reserves of at least three months of imports cover. Achieving these near-term goals would stabilize the macroeconomic situation, safeguard financial sector stability, and boost private sector confidence. They viewed maintaining the flexible exchange rate regime and the automatic fuel pricing mechanism as central to achieving these objectives.

A. Calibrating the Fiscal Stance to Restore Macroeconomic Stability

Near-Term Policy Issues

17. The adoption of a revised budget for FY15/16 in March 2016 constituted a critical step toward restoring macroeconomic stability. The changed macroeconomic outlook necessitated revisions to the fiscal framework. The revised budget adopted by parliament in early March 2016 is broadly in line with the program ceilings set at the time of the fifth and sixth reviews (March 2015). However, at that juncture, the prolonged effects of the drought were not known, and previous contributions to the donor-coordinated humanitarian relief (0.3 percent of GDP) were already exhausted (MEFP ¶4). By April 2016, it became apparent that the impact of the drought would be significantly more severe than previously anticipated.

18. In April 2016, the authorities declared a national disaster on the basis that the drought-induced damage to the harvest could put about half of the population in a state of food insecurity. Against this background, they requested additional donor support and IMF assistance through an augmentation of access (25 percent of quota) to respond to the looming humanitarian crisis. The authorities' preliminary estimate of the costs of the humanitarian response, replenishing the strategic grain reserves, and price stabilization amounts to US$450 million.

The humanitarian component is estimated to cost US$276 million based on the need for 790,000 metric tons of maize for food relief.

19. The humanitarian effort would cover both FY15/16 and FY16/17. In this regard, NDF in the FY15/16 fiscal framework would be increased by 0.4 percent of GDP through the augmentation to accommodate additional maize purchases. It was apparent that the draft budget FY16/17 that envisaged limiting NDF to about one percent of GDP, made inadequate provisions for maize purchases in light of the changed situation. The scale of the humanitarian needs had increased and the costs of procuring maize had risen owing to the region-wide effects of the drought and the possible necessity of importing some maize from outside the continent. Under the proposed augmentation, increasing NDF by 0.5 percent of GDP in FY16/17 would facilitate additional maize purchases. Recognizing that the drought-induced economic slowdown would negatively impact revenues and contribute to higher financing needs, the authorities committed to both cut and change the composition of spending. In particular, they agreed to cut fertilizer subsidies and contain the wage bill by limiting wage awards and removing ghost workers from the payroll (MEFP, ¶31). The domestic spending adjustment in FY16/17 amounts to about one percentage point of GDP.

Text Table 2. Revisions to the Fiscal Program Relative to Article IV[1]

	FY 15/16	FY16/17	FY 15/16	FY16/17
	(Billions of kwacha)		(In percent of GDP)	
Revenue and grants	**0**	**-30**	**0.0**	**-0.7**
of which Revenues	0	-3	0.0	-0.1
Total expenditure excl. securitization of arrears	**24**	**17**	**0.7**	**0.4**
Additional maize purchases	**13**	**20**	**0.4**	**0.5**
Domestic Spending adjustments	***3***	***-37***	***0.1***	***-0.9***
o/w				
Wages	-11	-13	-0.3	-0.3
Goods and services excl. maize	10	-13	0.3	-0.3
Subsidies	17	-12	0.5	-0.3
Foreign financed capital spending	**8**	**35**	**0.2**	**0.8**
Overall deficit	**-24**	**-47**	**-0.7**	**-1.1**
Total financing requirements (net)	24	47	0.7	1.1
Foreign (net)	0	2	0.0	0.0
Net domestic financing[2]	11	25	0.3	0.6
Financing gap[3]	13	20	0.4	0.5
ECF Augmentation	13	20	0.4	0.5
Memo item:				
Arrears payments	6	55	0.2	1.3

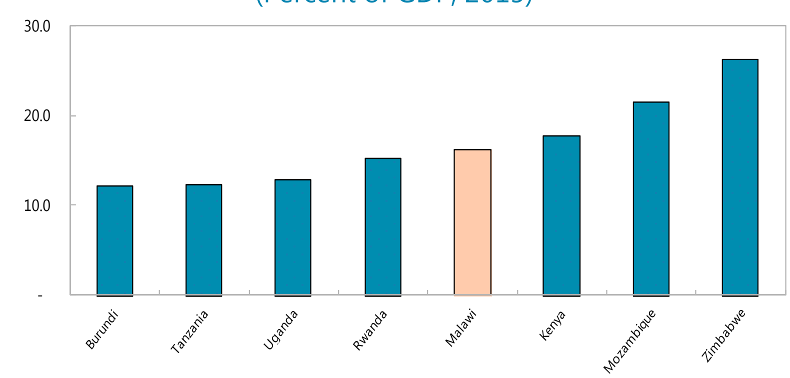
Source: IMF staff estimates.
[1] 2015 Article IV consultation.
[2]Excluding issuance of promissory notes for clearance of domestic arrears.
[3]To be filled by ECF augmentation.

20. Good progress was made in regularizing past domestic payment arrears (MEFP ¶7). Auditing of arrears incurred before FY14/15, which were estimated at MK157 billion (about 6 percent of GDP), is still proceeding. To date MK72 billion have been audited and securitized through the issuance of zero-coupon promissory notes of maturities varying from one to three years; MK30 billion claims have been rejected and about MK55 billion require additional documentation. Staff stressed the importance of strengthening commitment controls in order to prevent the emergence of new domestic arrears. In a bid to strengthen commitment controls, all Ministries, Departments, and Agencies (MDAs) are now required to provide five detailed fiscal reports before receiving their regular monthly funding. A recent report indicates that the incurrence of new arrears in the first half of FY15/16 was limited to 0.2 percent of GDP.

21. The authorities recognized the need for greater revenue mobilization given limited fiscal space and rising vulnerabilities (MEFP ¶28–¶30). To this end, they are implementing recommendations from the IMF's technical assistance on tax policy, including eliminating several tax exemptions. They also agreed in principle that tax policy reforms would be guided by a shift from the heavy reliance on taxes on factors of production to those on consumption. However, as most measures will require changes in legislation their potential yield in FY16/17 is uncertain.

Text Figure 4. Tax Revenue Compared to Neighboring Low-Income Countries

(Percent of GDP, 2015)



Sources: Malawian authorities and IMF staff estimates.

Medium-term Policy Issues

22. The pursuit of prudent fiscal policy will remain critical to safeguarding medium-term fiscal sustainability. To this end, the medium-term fiscal anchor comprises a primary fiscal balance consistent with a gradually declining net domestic financing, aimed at placing domestic debt on a declining trend while safeguarding social spending and limiting nonconcessional borrowing. The fiscal anchor takes in consideration Malawi's moderate risk of debt distress and vulnerabilities related to domestic debt. In order to ensure the long-term fiscal viability of the public pension scheme, the authorities committed to revisit proposed reforms to reduce liabilities of the current system (MEFP ¶35 and ¶36). The wage bill increases over the medium term, reflecting the recruitment of additional teachers in line with Malawi's poverty reduction strategy.

23. Reliability of fuel supply and the automatic fuel pricing mechanism have prevented growth-damaging disruptions in supply. Fuel importation which is currently managed by the private sector, has ensured reliability in supply with no costs to the budget. The authorities' plans to improve fuel storage capacity beyond 14 days given Malawi is landlocked is noteworthy. Nevertheless, the authorities underscored the need to balance fuel security with transparency and to mitigate the potential risks from contingent liabilities that could arise from a greater role for the state-owned oil company (MEFP ¶40–¶42).

B. Accelerating the Implementation of Priority PFM Reforms

24. The implementation of PFM reforms was progressing slowly, but has recently gained momentum (MEFP ¶13 and ¶33 and ¶34). Progress in implementing PFM reforms were initially slow contributing to the delay in completing the seventh review as scheduled (¶3), but has since picked up with the installation of a resident PFM advisor. The authorities have strengthened budget control by enforcing monthly fiscal reporting by MDAs and will soon place inspectors from the Ministry of Finance in the spending units to strengthen financial oversight. To further enhance fiscal transparency, the authorities have commenced publishing monthly budget execution reports. Cash management was strengthened by closing a large number of dormant accounts and by the institution of regular meetings of the cash management committee. The increased coverage of government spending within the integrated financial management system is facilitating bank reconciliations and serves as a safeguard against fraud. Staff stressed the need for regular oversight, accountability and the application of sanctions to public sector officials in accordance with the PFM Act if they fail to carry out their responsibilities. The sequencing and implementation of these reforms were supported by technical assistance from the Fund and development partners.

C. Strengthening Monetary Policy

25. Staff emphasized the need to maintain a tight monetary policy stance to ensure that inflation remains on a declining trajectory (MEFP, ¶20). Recent efforts to tighten the monetary policy stance, combined with supportive fiscal policies, have helped to reduce inflationary pressures and stabilize the kwacha despite rising food prices following weather-related shocks. The authorities committed to conduct a tight monetary policy by achieving positive short-term real money market interest rates through open market operations. With annual inflation at 21 percent through April, short-term money market rates are positive in real terms, but this needs to be sustained through open market operations to strengthen the monetary policy transmission mechanism.
They concurred with staff that the RBM has sufficient instruments to conduct effective liquidity management provided fiscal policy is supportive. The authorities are receiving IMF technical assistance to improve open market operations and liquidity forecasting. Staff noted that a recent Fund technical assistance mission had concluded that the money market works relatively well with

no sign of segmentation, and recommended that the central bank manage banking system liquidity more actively by keeping banks' excess reserves stable.

26. The RBM reiterated its commitment to further strengthening the monetary policy architecture. To this end, the RBM has enhanced its communication with the general public by better explaining policy changes and the envisaged future path for inflation. These efforts will strengthen policy credibility, increase the efficiency of policy transmission, and better anchor inflation expectations (MEFP, ¶21). Staff welcomed the recently introduced deposit facility, which, combined with the already existing Lombard facility, should effectively keep interbank interest rates to within 200 basis points on either side of the policy rate. The facility should also permit the central bank to guide short-term money market rates, allow the policy rate to play a signaling role regarding the stance of monetary policy, reduce interest rate volatility, and improve the monetary policy transmission mechanism.

D. Enhancing Financial Sector Stability

27. The authorities undertook important steps over the last two years to safeguard and strengthen financial sector stability (MEFP ¶23–¶25). They implemented a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action against distressed banks. The PCA framework has been complemented with a model resolution framework that outlines the various options that could be taken to intervene and resolve any problem bank that fails to submit or comply with an acceptable recapitalization plan. To improve prudential norms on asset classification and provisioning, a new asset classification directive has been implemented. The new directive, which is based on the estimated recoverable amount method (ERAM), imposes higher and graduated provisioning rates in order to strengthen banking sector resilience and improve banks' ability to deal with adverse developments. This measure should help increase provisioning rates going forward. Staff welcomed remedial actions being taken by the RBM to recapitalize two banks which have been affected by the new ERAM-based provisioning regulations (MEFP, ¶24). Vulnerabilities in the banking sector were reduced by the June 2015 sale of government's stake in two weak banks but remain elevated in a high inflation environment and shocks to the economy. A restructuring and integration of the two banks is proceeding under close monitoring from the central bank and is expected to be completed by December 2016.

28. The authorities remain committed to taking additional steps to strengthen the banking sector (MEFP ¶25). They are enhancing both on-site and off-site supervision, closely monitoring and enforcing compliance with prudential norms and enhancing the supervisory skills of RBM staff. Recent stress tests confirmed that credit risk stemming from loan concentration remains the most significant threat to the banking system. The direct impact of large exchange rate depreciation and increases in interest rates on banks' balance sheets were found to be moderate.[2]

[2] The effects of interest rate risk depend on the mismatch between interest rate sensitive assets and interest rate sensitive liabilities. The exchange rate effect is limited because of small net open positions.

Staff emphasized the need to closely monitor loan concentrations in the banking sector as this could constrain liquidity and erode banks' capital. Amendments to anti-corruption and the AML/CFT legal frameworks in line with international standards will help address fraud and related risks (MEFP, ¶13). In order to safeguard the integrity of the financial system, the authorities required banks to address deficiencies in loan documentation and followed up on incidents on noncompliance with the AML/CFT legal framework.

E. Preserving Debt Sustainability

29. The risk of external debt distress remains moderate. The debt sustainability analysis (DSA) undertaken jointly by Fund and World Bank staff concluded that, except for a very modest breach in 2016 in the debt service-to-revenue ratio, all external debt indicators remain well below their policy-dependent debt-burden thresholds. Moreover, the public and publicly guaranteed external debt-to-GDP and to export ratios in net present value (NPV) terms are expected to follow a declining trend, similar to the path envisioned in the previous WB/IMF DSA (March 2015).

30. Malawi's external debt profile is lower compared to the previous DSA. This reflects the rebasing of GDP at the time of the 2015 Article IV consultation. Stress tests indicate a somewhat weaker debt outcome is possible under certain assumptions, particularly under the historical scenario when future current account balances and foreign direct investment are equal to their average over the last 10 years. The DSA reflects the authorities' borrowing plan over 2016–17, which foresees US$77.5 million (1.2 percent of GDP) in new nonconcessional borrowing. This amount comprises US$55 million from the African Development Bank for a water project and US$22.5 million from China for an e-government project. The debt dynamics do not worsen significantly nor persistently as a result of this new borrowing. The authorities concurred with staff on the need to strengthen the debt management framework (MEFP, ¶39), identify risks associated with rapid debt accumulation, and ensure debt sustainability.

31. Domestic public debt as a percent of GDP has been increasing over the last four years but is projected to start declining in 2017 as NDF is contained. Domestic debt is projected to increase by 2 percentage points to 18.9 percent of GDP in 2016, mostly due to the securitization of old domestic arrears. It is projected, however, to decline steadily to 13 percent of GDP in 2019.

PROGRAM ISSUES

32. Completing the seventh and eighth reviews was conditional on the authorities implementing two prior actions (Table 10b). However, the reconciliation of all government accounts in MG1, five operational accounts and the ways and means account for the first half of FY15/16 is pending. The reconciliation of the salary account for the first half of FY15/16 was excluded from the prior action due to technical complexities that were encountered. Another prior action consisted of a preparation of a report on the flow and stock of arrears at end-2015 was met. In addition, the authorities reached understandings with staff on a set of structural benchmarks for the ninth review, encompassing the rephasing of several that were PFM related.

33. The authorities are requesting waivers for the nonobservance two periodic performance criteria (MEFP ¶43). The PC on net domestic borrowing was missed at end-June 2015 due mainly to the unplanned recruitment of teachers, revenue shortfalls, and unbudgeted wage increases. A waiver for this PC is requested on the basis of the strong remedial actions taken by the authorities since then to bring NDF back on track and into conformity with the end-December 2015 target. The PC on net international reserves was missed at end-December 2015 because of lower-than-programmed exports due to weather-related shocks. The RBM faced with an unexpectedly large shock, intervened more than programmed to slow the pace of depreciation. The RBM nonetheless allowed a very large depreciation of 36 percent in response to external shocks—in line with program understandings on the exchange rate regime.

34. The authorities are requesting an augmentation of access of 25 percent of quota (SDR 34.7 million) to respond to the humanitarian relief. This would represent about 21 percent of the estimated balance of payments gap. An augmentation of access of 25 percent of quota will keep Malawi's total annual access under the limit of 75 percent of quota for Poverty Reduction and Growth Trust financing.[3] The government's contribution would increase NDF for FY15/16 and FY16/17 by 0.4 and 0.5 percent, respectively. The relaxation of the fiscal stance should not create undue inflationary pressures if the additional NDF is used to finance maize imports as envisaged or if the central bank continues to mop up excess liquidity in the event that part of the additional NDF is used for domestic purchases.

Text Table 3. Drought-Related BOP Financing Needs in 2016

	US$ million	Percent of GDP
Maize imports	**233.6**	**4.1**
Ex-ante Financing Gap	**233.6**	**4.1**
Donor financing	185.1	3.2
Multilateral	118	2.0
Bilateral	67.1	1.2
IMF augmentation	48.5	0.8

Source: IMF staff estimates.

35. Donors are currently conducting vulnerability assessments and mobilizing resources for the relief efforts. Donors' assistance will be channeled off budget and managed within the context of an integrated humanitarian response by the World Food Program. This modality provides the necessary safeguards and serves as a mechanism for efficient relief coordination. The financing gap is fully closed throughout the remainder of the ECF arrangement with firm commitments by donors including the AfDB (US$18 million) and the World Bank (US$100 million).

[3] An augmentation of 25 percent of quota is within the range recently granted to sub-Saharan African countries that experienced a commodity shock and/or major catastrophe.

36. The authorities are also requesting an extension of the arrangement to end-December 2016 and a rephasing of disbursements. A short extension of the arrangement from May 22, 2016 to June 30, 2016 was approved by the Board on May 13, 2016 to give to the authorities' time to implement two prior actions for completing the seventh and eighth reviews. The requested extension to end-December 2016 would also give the authorities more time to achieve the original objectives of the program. As the program went off track, the implementation of several PFM structural reforms and the submission of amendments to the AML/CFT law to parliament were delayed. PCs on NDA of the central bank and NDF of the central government were set to ensure adequate financing of the budget, flexibility in responding to the food crisis, and placing inflation on a downward path. The PC on NIR is aligned with the original program objective of achieving at least three months of import cover. Finally, the new limit on nonconcessional borrowing is consistent with the authorities' poverty reduction strategy and does not worsen the debt dynamics significantly (¶30).

37. 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 would remain moderate.

38. A safeguards monitoring mission that took place in February 2016 found that steps have been taken to address control deficiencies in the RBM's banking operations. The mission thus recommended that the RBM's internal audit function conduct a special audit to provide assurances on the current controls over government payments at the RBM and identify and address remaining weaknesses. The mission retained the recommendation of the 2012 assessment for the RBM to draft additional amendments to the RBM law to strengthen the bank's financial and institutional autonomy. Finally, the RBM should review and revise its investment policy to protect against a concentration of investments with institutions with a rating below investment grade.

STAFF APPRAISAL

39. Malawi's macroeconomic situation remains difficult. This reflects the prolonged adverse impact of weather-related shocks and past policy slippages which contributed to persistently high inflation. The near-term outlook remains challenging as the maize harvest has been affected by drought for a second consecutive year and placed about half of the population at risk of food insecurity.

40. The authorities undertook corrective measures to bring the program back on track. Policy slippages during the first half of 2015 were corrected during the second half of the year by containing net domestic borrowing and tightening monetary conditions. The revised budget for fiscal year 2015/16 that was approved by parliament in March is in line with the program. On the structural side, reforms in the financial sector were carried out as planned and the authorities made substantial progress on bank reconciliation and in strengthening commitment controls.

41. Restoring macroeconomic stability is the most critical near term priority. Given that inflation has been stuck above 20 percent since 2012, maintaining fiscal and monetary policies is needed to reduce inflation. Reducing inflation will necessitate the implementation of a credible budget in FY16/17 in line with sustainable financing. Low inflation is also key to restoring private sector confidence, fostering growth, and building a solid foundation for reducing poverty.

42. Accelerating the implementation of PFM reforms is indispensable to building trust and confidence in the budget process and ensuring control over fiscal operations. Greater commitment control that contains voted expenditures to available resources will mitigate the emergence of domestic payment arrears and allow domestic financing to be limited to budgeted amounts. The restoration of routine bank reconciliation and regular fiscal reporting is critical to fostering donor re-engagement in light of Malawi's structurally weak external position.

43. Greater revenue mobilization is key to reducing aid dependency, mitigating policy slippages, and ensuring reliable financing of Malawi's sustainable development goals. In this regard, the authorities are encouraged to explore new tax policy measures, strengthen tax compliance, and modernize their tax administration.

44. Improving expenditure efficiency will create fiscal space for social and other priority spending. The authorities are commended for initiating reforms to the farm input subsidy program, which is ill-targeted, and implementing a payroll audit and a headcount to eliminate ghost workers, and to strengthen control over the wage bill.

45. The authorities are commended for improving the resilience of the banking system. Important measures implemented comprise the adoption of measures to intervene in distressed banks, the introduction of new asset classification directive, and regular stress testing of banks' balance sheets. Given recent shocks, and the prevalence of concentration risk as the most important threat to financial sector stability, staff encourages the authorities to consider higher capital requirements, improving credit assessments, higher provisioning, and bank mergers in order to mitigate this risk. Strengthening creditor rights and reducing lengthy judicial processes in recovering collateral remain critical to the reduction of NPLs.

46. The flexible exchange rate regime and the automatic fuel pricing mechanism have served Malawi well as shock absorbers. Staff cautions that any changes to the fuel import regime, notably to improve fuel security should be fully transparent and include consultations with all stakeholders to avoid growth-damaging disruptions in supply.

47. Staff recommends the completion of the seventh and eighth reviews. This recommendation is based on strong policy implementation during the second half of 2015 to bring the program back on track, on completion of prior actions for the two reviews, and on the strength of the reform agenda articulated by the authorities in their memorandum of economic and financial policies. Staff also supports the authorities' request for waivers on missed PCs for the seventh and eighth reviews based on the strong corrective actions already taken. Staff further supports the extension of the arrangement, rephasing of disbursements, and the augmentation of access under the ECF arrangement.

Table 1. Malawi: Selected Economic Indicators, 2012–19
(with rebased nominal GDP)

26-May-16	2012	2013	2014	2015	2016	2017	2018	2019
		Act.		Est.		Proj.		
National accounts and prices (percent change, unless otherwise indicated)								
GDP at constant market prices	1.9	5.2	5.7	3.0	2.7	4.5	5.0	5.5
Nominal GDP (billions of Kwacha)[1]	1,502	2,011	2,570	3,203	3,892	4,601	5,230	5,932
GDP deflator	17.7	27.3	20.9	21.0	18.3	13.1	8.3	7.5
Consumer prices (end of period)	34.6	23.5	24.2	24.9	15.8	9.9	8.9	8.6
Consumer prices (annual average)	21.3	28.3	23.8	21.9	19.7	14.1	9.4	8.7
Investment and savings (percent of GDP)								
National savings	2.8	4.0	3.5	3.2	-0.4	4.5	6.1	6.4
Gross investment	12.1	12.7	12.0	11.4	13.6	13.2	14.1	14.0
Government	5.8	5.3	4.6	4.6	6.5	6.0	6.7	6.5
Private	6.3	7.4	7.5	6.8	7.0	7.2	7.4	7.5
Saving-investment balance	-9.3	-8.7	-8.5	-8.2	-13.9	-8.8	-8.0	-7.7
Central government (percent of GDP on a fiscal year basis)[2]								
Revenue	18.7	27.5	22.8	21.4	22.5	21.5	21.7	21.8
Tax and nontax revenue	15.6	17.3	19.7	18.6	18.6	18.6	18.8	18.8
Grants	3.1	10.2	3.1	2.8	3.9	2.9	2.9	2.9
Expenditure and net lending	23.5	28.5	28.9	27.9	28.6	26.4	24.4	24.4
Overall balance (excluding grants)	-7.9	-11.2	-9.2	-9.3	-10.0	-7.9	-5.6	-5.6
Overall balance (including grants)	-4.8	-1.0	-6.1	-6.5	-6.1	-5.0	-2.7	-2.6
Foreign financing	1.1	1.9	2.0	2.5	3.1	2.3	2.1	2.1
Total domestic financing	4.7	-0.1	4.2	4.1	2.6	2.3	0.6	0.5
Financing gap	0.0	0.0	0.0	0.0	0.4	0.5	0.0	0.0
Discrepancy	-1.1	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)								
Money and quasi money	22.9	35.1	20.7	23.7	16.7	16.9	21.7	23.6
Net foreign assets	9.3	26.5	20.6	15.5	-1.8	5.1	9.8	9.8
Net domestic assets	13.6	8.6	0.1	8.1	18.4	11.8	11.9	13.8
Credit to the government	0.0	11.3	-5.9	8.1	10.1	3.3	2.3	2.1
Credit to the private sector (percent change)	25.4	14.4	20.0	29.9	20.3	18.9	20.3	22.2
External sector (US$ millions, unless otherwise indicated)								
Exports (goods and services)	1,421	1,657	1,737	1,616	1,670	1,747	1,871.7	2,005.7
Imports (goods and services)	2,281	2,315	2,399	2,284	2,604	2,476	2,590.5	2,736.8
Gross official reserves	236	397	588	670	660	705	782.0	889.9
(months of imports)	1.2	2.0	3.1	3.4	3.2	3.3	3.4	3.6
(percent of reserve money)	69.1	108.3	130.3	216.2	181.0	161.0	155.0	151.6
Current account (percent of GDP)[3]	-9.3	-8.7	-8.5	-8.2	-13.9	-8.8	-8.0	-7.7
Current account, excl. official transfers (percent of GDP)[3]	-12.3	-10.0	-8.5	-8.6	-13.9	-8.7	-7.9	-7.7
Real effective exchange rate (percent change)	-17.9	-14.9	8.8	14.3	...	...	…	…
Overall balance (percent of GDP)	1.6	3.1	2.7	0.9	-1.5	0.4	1.4	1.6
Financing gap	0.0	0.0	0.0	0.0	48.5	42.6	0.0	0.0
Terms of trade (percent change)	-3.0	1.1	2.2	13.5	5.9	-4.6	-2.1	-3.0
Debt stock and service (percent of GDP, unless otherwise indicated)								
External debt (public sector)	26.5	30.8	33.1	37.0	33.2	29.1	29.2	29.3
NPV of external debt (percent of exports)	53.3	77.3	102.9	110.9	86.4	83.0	82.7	82.0
Domestic public debt	13.8	19.8	14.9	16.8	18.9	18.0	15.5	13.3
Total public debt	40.2	50.6	48.0	53.8	52.1	47.1	44.7	42.5
External debt service (percent of exports)	1.4	1.7	4.3	5.2	11.8	9.6	5.3	4.5
External debt service (percent of revenue excl. grants)	2.1	2.8	6.6	7.2	18.3	12.7	7.4	6.1
91-day treasury bill rate (end of period)	20.0	32.3	26.9	22.2	...	…	…	…

Sources: Malawian authorities and IMF staff projections.

[1] The current GDP base year is 2010.
[2] The fiscal year starts in July and ends in June. The current fiscal year, 2016, runs from July 1, 2015 to June 30, 2016.
[3] Numbers reflect re-classification of project and dedicated grants from current account to capital account.

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

	2012/13	2013/14	2014/15	2015/16			2016/17		2017/18	2018/19
26-May-16	Actual	Actual	Actual	Prog.[1]	Revised Budget	Proj.	Prelim. budget	Proj.	Proj.	
Revenue	472	511	610	774	792	792	905	905	1,062	1,209
Tax and nontax revenue	297	441	530	648	655	655	784	784	920	1,046
Tax Revenue	269	388	463	579	583	583	709	709	832	944
Taxes on income and profits	129	181	233	289	304	304	393	393	455	517
Taxes on goods and services	111	168	189	237	234	234	264	264	312	354
Taxes on international trade	33	41	46	63	55	55	58	58	71	80
Other taxes	-4	-2	-6	-10	-9	-9	-5	-5	-6	-7
Nontax revenue [2]	28	53	67	69	72	72	75	75	89	102
Grants	176	70	79	126	137	137	122	122	141	163
Budget support grants	78	7	0	7	21	21	0	0	0	0
Project grants	35	41	48	76	68	68	73	73	77	85
Dedicated grants	64	22	32	43	49	49	49	49	64	78
Expenditure and net lending	489	647	794	841	987	1,006	1,096	1,116	1,196	1,355
Current expenditure	385	547	642	650	749	768	842	862	879	972
Wages and salaries	97	140	197	193	222	222	261	261	313	360
Interest payments	33	98	115	108	116	116	144	144	128	109
Domestic	29	94	108	90	106	105	132	132	114	93
Foreign	4	4	7	19	11	11	12	12	13	16
Goods and services	144	176	158	184	190	203	211	231	254	294
Generic goods and services	60	65	78	77	75	75	82	82	95	108
Road Maintenance	7	8	9	11	21	21	21	21	30	36
Agricultural SWAP		9	0	2	7	7	8	8	9	10
Health SWAP	32	20	23	37	32	32	38	38	44	52
Education SWAP	22	19	23	29	21	21	25	25	28	33
National / local elections	1	11	1	1	1	1	2	2	2	2
PFEM		3	1	1	4	4	4	4	4	4
Statutory expenditures	6	7	8	3	6	6	5	5	6	6
National AIDS Commission	5	9	3	5	8	8	13	13	15	16
Maize purchases	3	14	5	6	9	22	5	25	12	13
Rural Electrification Program	8	10	6	11	6	6	9	9	10	12
Subsidies and other current transfers	98	125	139	165	172	172	166	166	184	209
Pension and gratuities	16	20	31	30	43	43	50	50	58	66
Transfers to road and revenue authorities	8	13	14	17	13	13	21	21	25	28
Transfers to public entities and households	22	32	39	42	53	53	55	55	55	62
Fertilizer and seed subsidy	52	60	55	75	64	64	40	40	46	53
Of which : seed subsidy	6	9	4	...	9	9	10	10	11	13
Arrears payments[3]	12	8	33	0	48	54	60	60	0	0
of which : bonds for securitizing domestic arrears			22	0	48	54	55	55	0	0
Development expenditure	104	100	152	191	236	236	250	250	312	378
Foreign financed	72	81	124	133	209	209	216	216	208	233
Domestically financed	32	20	28	58	27	27	35	35	104	145
Net lending	0	0	1	0	2	2	4	4	4	5
Overall balance (including grants)	-16	-136	-185	-67	-194	-214	-190	-210	-134	-146
Discrepancy	-14	-2	-1	0	0	0	0	0	0	0
Overall balance (incl. grants and discrepancy)	-30	-138	-186	-67	-194	-214	-190	-210	-134	-146
Total financing (net)	30	138	186	67	194	201	190	190	135	146
Foreign financing (net)	33	45	70	42	110	110	95	95	105	116
Borrowing	38	54	82	74	132	132	121	121	131	148
Budget support loans	0	14	0	18	0	0	0	0	0	0
Project loans	38	40	61	57	121	121	121	121	131	148
Other external loans[4]	0	0	20	0	12	12	0	0	0	0
Amortization	-5	-9	-12	-32	-22	-22	-26	-26	-27	-32
Issuance of promissory notes for securitizing domestic arrears			22	0	48	54	55	55	0	0
Privatization proceeds	0	0	0	0	11	11	0	0	0	0
Net domestic financing (NDF)	-2	93	94	25	25	25	40	40	30	30
Financing gap	0	0	0	0	0	13	0	20	0	0
Memorandum items:										
Primary balance (including grants and discrepancy)	3	-40	-71	42	-77.9	-97.5	-46	-66	-7	-37
Domestic fiscal balance[5]	-120	-126	-139	-61	-120.9	-140.5	-93	-113	-64	-71
Maturing promissory notes for domestic arrears	0	0	0	---	---	15.0	42	42	30	30
Nominal GDP	1,717	2,242	2,848	2,377	3,520.5	3,520.5	4,219	4,219	4,891	5,554

Sources: Malawi Ministry of Finance and IMF staff projections.

[1]Data from the IMF Country Report No. 15/83.

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

[3]This includes promissory notes issued for the repayment of domestic arrears accumulated before FY2014/15.

[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, 2012/13–2018/19
(Percent of GDP)

26-May-16	2012/13	2013/14	2014/15	2015/16			2016/17		2017/18	2018/19
	Actual	Actual	Actual	Prog.[1]	Revised Budget	Proj.	Prelim. budget	Proj.	Proj.	
Revenue	27.5	22.8	21.4	32.6	22.5	22.5	21.5	21.5	21.7	21.8
Tax and nontax revenue	17.3	19.7	18.6	27.3	18.6	18.6	18.6	18.6	18.8	18.8
Tax Revenue	15.7	17.3	16.3	24.4	16.6	16.6	16.8	16.8	17.0	17.0
Taxes on income and profits	7.5	8.1	8.2	12.2	8.6	8.6	9.3	9.3	9.3	9.3
Taxes on goods and services	6.4	7.5	6.6	10.0	6.6	6.6	6.3	6.3	6.4	6.4
Taxes on international trade	1.9	1.8	1.6	2.7	1.6	1.6	1.4	1.4	1.4	1.4
Other taxes	-0.2	-0.1	-0.2	-0.4	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1
Nontax revenue[2]	1.6	2.4	2.4	2.9	2.0	2.0	1.8	1.8	1.8	1.8
Grants	10.2	3.1	2.8	5.3	3.9	3.9	2.9	2.9	2.9	2.9
Budget support grants	4.5	0.3	0.0	0.3	0.6	0.6	0.0	0.0	0.0	0.0
Project grants	2.0	1.8	1.7	3.2	1.9	1.9	1.7	1.7	1.6	1.5
Dedicated grants	3.7	1.0	1.1	1.8	1.4	1.4	1.2	1.2	1.3	1.4
Expenditure and net lending	28.5	28.9	27.9	35.4	28.0	28.6	26.0	26.4	24.4	24.4
Current expenditure	22.4	24.4	22.5	27.3	21.3	21.8	20.0	20.4	18.0	17.5
Wages and salaries	5.7	6.2	6.9	8.1	6.3	6.3	6.2	6.2	6.4	6.5
Interest payments	1.9	4.4	4.0	4.6	3.3	3.3	3.4	3.4	2.6	2.0
Domestic	1.7	4.2	3.8	3.8	3.0	3.0	3.1	3.1	2.3	1.7
Foreign	0.2	0.2	0.3	0.8	0.3	0.3	0.3	0.3	0.3	0.3
Goods and services	8.4	7.9	5.5	7.7	5.4	5.8	5.0	5.5	5.2	5.3
Generic goods and services	3.5	2.9	2.7	3.3	2.1	2.1	1.9	1.9	1.9	1.9
Road Maintenance	0.4	0.4	0.3	0.5	0.6	0.6	0.5	0.5	0.6	0.6
Agricultural swap	0.0	0.4	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Health SWAp	1.8	0.9	0.8	1.5	0.9	0.9	0.9	0.9	0.9	0.9
Education SWAp	1.3	0.9	0.8	1.2	0.6	0.6	0.6	0.6	0.6	0.6
National / local elections	0.0	0.5	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
PFEM	0.0	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Statutory expenditures	0.3	0.3	0.3	0.1	0.2	0.2	0.1	0.1	0.1	0.1
National AIDS Commission	0.3	0.4	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Maize purchases	0.2	0.6	0.2	0.3	0.2	0.6	0.1	0.6	0.2	0.2
Rural Electrification Program	0.5	0.5	0.2	0.5	0.2	0.2	0.2	0.2	0.2	0.2
Subsidies and other current transfers	5.7	5.6	4.9	6.9	4.9	4.9	3.9	3.9	3.8	3.8
Pension and gratuities	0.9	0.9	1.1	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Transfers to road and revenue authorities	0.5	0.6	0.5	0.7	0.4	0.4	0.5	0.5	0.5	0.5
Transfers to public entities	1.3	1.4	1.4	1.8	1.5	1.5	1.3	1.3	1.1	1.1
Fertilizer and seed subsidy	3.0	2.7	1.9	3.2	1.8	1.8	0.9	0.9	0.9	0.9
Of which : seed subsidy	0.3	0.4	0.1	...	0.3	0.3	0.2	0.2	0.2	0.2
Arrears payments[3]	0.7	0.4	1.2	0.0	1.4	1.5	1.4	1.4	0.0	0.0
of which : bonds for securitizing domestic arrears			0.8		1.4	1.5	1.3	1.3	0.0	0.0
Development expenditure	6.1	4.5	5.3	8.0	6.7	6.7	5.9	5.9	6.4	6.8
Foreign financed	4.2	3.6	4.4	5.6	5.9	5.9	5.1	5.1	4.3	4.2
Domestically financed	1.8	0.9	1.0	2.5	0.8	0.8	0.8	0.8	2.1	2.6
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Overall balance (including grants)	-0.9	-6.1	-6.5	-2.8	-5.5	-6.1	-4.5	-5.0	-2.7	-2.6
Discrepancy	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-1.7	-6.1	-6.5	-2.8	-5.5	-6.1	-4.5	-5.0	-2.7	-2.6
Total financing (net)	1.8	6.1	6.5	2.8	5.5	5.7	4.5	4.5	2.8	2.6
Foreign financing (net)	1.9	2.0	2.5	1.8	3.1	3.1	2.3	2.3	2.1	2.1
Borrowing	2.2	2.4	2.9	3.1	3.8	3.8	2.9	2.9	2.7	2.7
Budget support loans	0.0	0.6	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Project loans	2.2	1.8	2.2	2.4	3.4	3.4	2.9	2.9	2.7	2.7
Other external loans[4]	0.0	0.0	0.7	0.0	0.3	0.3	0.0	0.0	0.0	0.0
Amortization	-0.3	-0.4	-0.4	-1.4	-0.6	-0.6	-0.6	-0.6	-0.5	-0.6
Issuance of promissory notes for securitizing domestic arrears			0.8		1.4	1.5	1.3	1.3	0.0	0.0
Privatization proceeds	0.0	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0
Net domestic financing (NDF)	-0.1	4.2	3.3	1.0	0.7	0.7	0.9	0.9	0.6	0.5
Financing gap	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.5	0.0	0.0
Memorandum items:										
Primary balance (including grants and discrepancy)	0.2	-1.8	-2.5	1.7	-2.2	-2.8	-1.1	-1.6	-0.1	-0.7
Domestic fiscal balance[5]	-7.0	-5.6	-4.9	-2.5	-3.4	-4.0	-2.2	-2.7	-1.3	-1.3
Maturing promissory notes for domestic arrears	0.0	0.0	0.0	---	---	0.4	1.0	1.0	0.6	0.5
Nominal GDP (fiscal year)	1,717	2,242	2,848	2,377	3,521	3,521	4,219	4,219	4,891	5,554

Sources: Malawi Ministry of Finance and IMF staff projections.

[1]Data from the IMF Country Report No. 15/83.

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

[3]This includes promissory notes issued for the repayment of domestic arrears accumulated before FY2014/15.

[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: 2015/16 and 2016/17

(Billions of Kwacha)

	2015/16					2016/17				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	187.3	156.2	231.8	217.1	792.4	197.3	206.5	252.7	248.9	905.4
Tax and nontax revenue	149.8	149.9	164.6	190.6	654.9	174.6	196.0	196.0	217.4	783.8
Tax revenue	138.3	133.2	145.2	166.3	583.0	155.8	177.2	177.2	198.6	708.8
Taxes on income and profits	71.2	67.6	77.2	87.5	303.5	76.8	98.2	98.2	119.6	392.7
Taxes on goods and services	54.0	54.9	57.6	67.5	233.8	65.9	65.9	65.9	65.9	263.7
Taxes on international trade	13.5	12.6	13.7	14.9	54.7	14.4	14.4	14.4	14.4	57.8
Other taxes	-0.4	-1.8	-3.2	-3.6	-9.0	-1.3	-1.3	-1.3	-1.3	-5.4
Nontax revenue [1]	11.5	16.7	19.4	24.3	71.9	18.8	18.8	18.8	18.8	75.0
Grants	37.5	6.3	67.2	26.5	137.5	22.8	10.6	56.8	31.5	121.6
Budget support grants	18.0	0.0	0.0	2.5	20.5	0.0	0.0	0.0	0.0	0.0
Project grants	7.7	0.2	40.1	20.0	67.9	9.8	2.9	39.6	20.7	73.0
Dedicated grants	11.9	6.1	27.1	3.9	49.1	13.0	7.6	17.2	10.8	48.6
Expenditure and net lending	230.8	174.3	351.8	249.1	1,006.0	264.5	234.6	318.2	298.5	1,115.8
Current expenditure	182.2	158.7	225.7	201.5	768.1	217.7	201.6	220.3	222.6	862.2
Wages and salaries	55.8	56.2	53.6	56.6	222.3	65.2	65.2	65.2	65.2	261.0
Interest payments	19.2	23.3	28.2	45.4	116.2	36.7	28.5	44.6	34.2	144.1
Domestic	18.0	19.6	25.3	42.7	105.5	34.0	25.7	41.4	31.1	132.3
Foreign	1.3	3.7	3.0	2.7	10.7	2.7	2.8	3.2	3.1	11.8
Goods and services	66.4	42.8	38.1	55.7	202.9	73.4	51.0	50.0	56.6	231.0
Generic goods and services	30.1	16.0	12.9	16.3	75.4	20.5	20.5	20.5	20.5	82.0
Road Maintenance	5.0	7.5	6.5	1.9	21.0	4.8	4.8	4.8	6.9	21.3
Agricultural swap	1.2	3.9	1.0	0.5	6.5	1.9	1.9	1.9	1.9	7.8
Health SWAp	9.1	7.1	6.8	9.4	32.4	9.6	9.6	6.9	12.3	38.5
Education SWAp	7.8	6.3	2.8	3.8	20.6	8.2	6.1	4.1	6.1	24.5
National / local elections	0.3	0.4	0.5	0.0	1.2	0.4	0.4	0.4	0.4	1.5
PFEM	0.1	0.1	2.1	1.8	4.1	0.9	0.9	0.9	0.9	3.8
Statutory expenditures	3.7	0.3	1.1	0.9	6.0	1.6	1.2	1.0	1.0	4.9
National AIDS Commission	2.0	0.0	3.1	3.1	8.2	3.2	3.2	3.2	3.2	12.8
Maize purchases	5.8	0.0	1.0	14.7	21.6	20.0	0.0	5.0	0.0	25.0
Rural Electrification Program	1.2	1.3	0.3	3.1	5.8	2.3	2.3	1.3	3.3	9.0
Subsidies and other current transfers	31.5	36.4	65.6	38.9	172.4	27.3	41.9	45.4	51.6	166.1
Pension and gratuities	10.7	9.4	9.3	13.7	43.1	12.4	14.9	11.4	11.4	50.2
Transfers to road and revenue authorities	3.9	3.7	2.2	3.0	12.8	4.1	5.3	5.9	5.9	21.3
Transfers to public entities and households	16.9	12.3	15.0	8.3	52.5	7.6	11.7	17.7	17.7	54.7
Of which, roofing sheets and cement program	2.0	1.0	3.0	1.0	7.0	1.8	1.8	1.8	1.8	7.0
Fertilizer and seed subsidy	0.0	11.0	39.0	13.9	63.9	3.2	10.0	10.3	16.5	40.0
Arrears payments	9.2	0.0	40.2	5.0	54.4	15.0	15.0	15.0	15.0	60.0
Of which, zero-coupon promissory notes	9.2	0.0	40.2	5.0	54.4	13.8	13.8	13.8	13.8	55.0
Development expenditure	48.0	14.9	126.0	47.5	236.4	46.8	33.0	98.0	72.3	250.1
Foreign financed	36.6	9.4	121.0	42.1	209.1	46.4	10.4	97.9	60.9	215.6
Domestically financed	11.5	5.6	5.0	5.4	27.3	0.4	22.6	0.1	11.5	34.5
Net lending	0.5	0.8	0.2	0.1	1.5	0.0	0.0	0.0	3.5	3.5
Overall balance (including grants)	-43.4	-18.1	-120.1	-32.1	-213.7	-67.1	-28.1	-65.5	-49.6	-210.3
Discrepancy	-2.6	20.9	1.5	-19.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-46.0	2.8	-118.5	-52.0	-213.7	-67.1	-28.1	-65.5	-49.6	-210.3
Total financing (net)	46.0	-2.8	118.5	39.0	200.7	47.1	28.1	65.5	49.6	190.4
Foreign financing (net)	29.5	0.3	53.4	27.2	110.3	23.4	-0.7	41.8	30.9	95.4
Borrowing	31.2	5.3	61.5	34.4	132.4	30.2	6.4	47.7	36.6	121.0
Budget support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project	23.0	5.3	58.0	34.3	120.6	30.2	6.4	47.7	36.6	121.0
Other external loans	8.2	0.0	3.5	0.1	11.8	0.0	0.0	0.0	0.0	0.0
Amortization	-1.7	-5.1	-8.1	-7.3	-22.1	-6.8	-7.1	-5.9	-5.8	-25.6
Issuance of promissory notes for securitizing domestic arrears	9.2	0.0	40.2	5.0	54.4	13.8	13.8	13.8	13.8	55.0
Privatization proceeds	0.0	0.0	11.0	0.0	11.0	0.0	0.0	0.0	0.0	0.0
Net domestic financing	7.3	-3.0	13.9	6.8	25.0	10.0	15.0	10.0	5.0	40.0
Fiscal gap	0.0	0.0	0.0	13.0	13.0	20.0	0.0	0.0	0.0	20.0
Memorandum item:										
Primary balance (including grants and discrepancy)	-26.7	26.1	-90.3	-6.6	-97.5	-30.4	0.5	-20.9	-15.4	-66.2
Domestic fiscal balance [2]	-43.9	-14.3	-66.0	-16.3	-140.5	-43.5	-28.3	-24.4	-16.7	-112.9
Maturing zero-coupon promissory notes	0.0	0.0	7.5	7.5	15.0	10.4	10.4	10.4	10.4	41.5

Sources: Malawi Ministry of Finance and IMF staff estimates and projections.

[1]Nontax revenue in 2014/15 includes the RBM profit transfer of MK25.4 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, 2012–19
(Billions of Kwacha, unless otherwise indicated)

31-May-16	2012	2013	2014	2015 June	2015 Dec. Prog.[1]	2015 Dec. Act.	2016 June Proj.	2016 Sept. Proj.	2016 Dec. Proj.	2017	2018	2019
Reserve money	113	157	212	213	261	206	176	226	247	300	370	458
Currency outside banks	55	76	98	112	...	111	...	...	...	...	…	…
Cash in vault	16	19	22	22	...	29	...	...	...	...	…	…
Commercial bank deposits with RBM	42	62	92	92	...	66	...	...	...	...	…	…
Net foreign assets (NFA)	-20	42	146	192	197	276	240	255	255	304	402	525
Foreign assets	80	174	277	311	312	445	410	429	447	483	574	694
Foreign liabilities	-100	-133	-131	-119	-115	-169	-170	-173	-192	-179	-171	-169
Net domestic assets	133	115	66	21	64	-70	-64	-29	-8	-4	-32	-67
Credit to government (net)	110	126	77	18	92	100	117	139	142	148	128	98
Credit to domestic banks	-14	0	0	6	0	0	0	0	0	0	0	0
Other items (net)	37	-11	-11	-2	-28	-171	-181	-169	-150	-152	-161	-165
Open market operations	-14	-5	0	0	...	-100	...	...	...	...	…	…
Others	51	8	-11	-2	...	-71	...	...	...	...	…	…
Memorandum items:												
Money multiplier	3.4	3.3	3.0	3.0	2.8	3.8	4.0	3.8	3.7	3.5	3.5	3.5
Annual growth of reserve money (percent)	54.6	38.6	35.3	10.2	21.4	-3.0	-17.1	14.2	19.8	21.5	23.4	23.6
91-day treasury bill rate	20.0	32.3	26.9	26.9	...	22.2	...	...	...	...	…	…
NFA (US$ millions)	-50	99	310	434	440	416	381	387	376	443	548	673
Foreign assets (US$ millions)	247	404	588	705	698	670	650	650	660	705	782	890
Foreign liabilities (US$ millions)	-297	-305	-278	-271	-258	-254	-269	-263	-284	-262	-233	-217

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

[1]Data from the IMF Country Report No. 15/83.

Table 3b. Malawi: Monetary Survey, 2012–19
(Billions of Kwacha, unless otherwise indicated)

	2012	2013	2014	2015		2016	2017	2018	2019
26-May-16				June	Dec.		Proj.		
				Act.	Act.				
Money and quasi-money	386	522	630	642	779	909	1,062	1,292	1,597
Money	222	201	275	289	318	...	...	...	...
Quasi-money	164	321	355	353	461	...	...	...	...
Of which: foreign currency deposits	72	139	143	130	207	...	...	...	...
Net foreign assets (NFA)	32	134	242	256	339	326	372	476	603
Monetary authorities	-20	42	146	192	276	255	304	402	525
Gross foreign assets	80	174	277	311	445	447	483	574	694
Foreign liabilities	-100	-133	-131	-119	-169	-192	-179	-171	-169
Commercial banks (net)	51	92	96	64	63	71	68	73	78
Net domestic assets	355	388	388	386	439	583	690	816	995
Credit to government (net)	141	184	153	149	204	283	313	337	365
Credit to statutory bodies (net)	19	18	4	6	5	6	8	9	11
Credit to private sector	219	250	301	312	390	469	558	671	820
Other items (net)	-24	-65	-70	-80	-160	-175	-189	-201	-201
Memorandum items:									
Velocity of money (annualized GDP divided by broad money)	3.9	3.9	4.1	...	4.1	4.3	4.3	4.0	3.7
Annual growth of broad money (percent)	22.9	35.1	20.7	13.8	23.7	16.7	16.9	21.7	23.6
Annual growth of credit to the private sector (percent)	25.4	14.4	20.0	13.6	29.9	20.3	18.9	20.3	22.2
NFA of the commercial banks (US$ millions)	153.3	212.3	203.2	145.8	95.0	105.0	100.0	100.0	100.0
Gross foreign assets (US$ millions)	199.5	242.1	239.9	168.2	156.4	166.4	161.4	161.4	161.4
Foreign liabilities (US$ millions)	-46.3	-29.8	-36.7	-22.4	-61.4	-61.4	-61.4	-61.4	-61.4
Foreign currency deposits(US$ millions)	218.2	325.5	304.0	293.9	...	...	...	...	...
Nominal GDP (billions of Kwacha)	1502	2011	2,570		3,203	3,892	4,601	5,230	5,932

Sources: Reserve Bank of Malawi and IMF staff projections.

Table 4a. Malawi: Balance of Payments, 2012–19
(Millions of USD, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019
2-Jun-16	Act.	Est.	Est.	Est.		Proj.		
Current account balance (including grants)	-555.0	-470.8	-515.2	-526.1	-803.6	-597.8	-584.9	-600.5
Merchandise trade balance	-659.1	-442.4	-468.5	-450.0	-678.4	-476.5	-472.2	-493.1
Exports	1,272.0	1,500.2	1,561.1	1,484.9	1,551.8	1,625.7	1,733.9	1,855.3
Of which: Tobacco	480.9	432.8	470.7	517.4	547.8	569.4	597.9	631.8
Uranium	154.4	169.9	40.4	0.0	0.0	0.0	0.0	0.0
Imports	-1,931.1	-1,942.6	-2,029.6	-1,934.9	-2,230.2	-2,102.2	-2,206.1	-2,348.4
Of which : Petroleum	-173.7	-176.6	-183.0	-101.4	-87.7	-116.2	-131.3	-143.7
Maize					-233.6	-42.4		
Services balance	-336.3	-375.0	-355.0	-389.7	-430.5	-428.3	-424.1	-425.4
Interest public sector	-10.0	-9.1	-8.7	-15.0	-33.9	-28.8	-22.3	-23.5
Other factor payments (net)	-124.8	-150.3	-151.9	-156.6	-141.0	-147.6	-155.1	-163.9
Nonfactor (net)	-243.9	-215.5	-194.4	-218.1	-255.5	-251.9	-246.7	-238.0
Receipts	148.8	156.5	175.4	130.6	118.1	121.3	137.8	150.4
Payments	-350.4	-372.0	-369.8	-348.7	-373.6	-373.2	-384.5	-388.4
Unrequited transfers (net)	440.5	346.6	308.2	313.6	305.3	307.0	311.4	318.0
Private (net)	259.8	274.4	309.0	287.8	306.1	307.9	312.3	318.9
Official (net)	180.7	72.2	-0.8	25.8	-0.8	-0.8	-0.8	-0.8
Receipts	181.4	73.0	0.0	26.6	0.0	0.0	0.0	0.0
Budget support	181.4	73.0	0.0	26.6	0.0	0.0	0.0	0.0
Payments	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Capital account balance	409.8	433.6	261.1	263.1	505.5	359.9	360.1	374.6
Project and dedicated grants[1]	409.8	433.6	261.1	263.1	505.5	359.9	360.1	374.6
Financial account balance	243.3	120.6	488.3	322.4	210.1	262.3	332.4	352.1
Medium- and long-term flows (net)	76.0	86.0	182.4	99.1	48.6	67.9	151.7	164.2
Disbursements	93.4	96.7	224.4	148.5	185.3	189.5	202.8	215.3
Budget support and other program loans	0.0	22.4	40.0	0.0	0.0	0.0	0.0	0.0
Project support	76.0	63.3	145.6	126.4	174.1	183.6	193.7	204.4
Other medium-term loans	17.4	11.1	38.8	22.1	11.3	5.9	9.1	10.9
Amortization	-17.4	-10.7	-42.0	-49.5	-136.7	-121.7	-51.1	-51.1
Foreign direct investment and other inflows	81.9	92.9	296.0	114.3	170.6	188.6	179.7	186.9
Short-term capital	0.7	0.8	0.8	0.8	0.9	0.9	1.0	1.0
Commercial banks net foreign assets	84.7	-59.1	9.1	108.2	-10.0	5.0	0.0	0.0
Errors and omissions	-4.9	85.2	-71	0.0	0.0	0.0	0.0	0.0
Overall balance	93.3	168.6	163.7	59.3	-88.1	24.4	107.6	126.2
Financing	-93.3	-168.6	-163.7	-59.3	39.6	-66.8	-107.6	-126.2
Gross reserves (- increase)	-45.6	-161.2	-190.6	-82.7	10.3	-45.0	-79.3	-109.7
Liabilities	-47.6	-7.4	26.9	23.4	29.3	-21.8	-28.3	-16.5
Of which: IMF (net)	37.0	12.6	-5.4	-6.1	29.3	-21.8	-28.3	-16.5
Purchases/drawings	40.2	20.1	17.6	18.2	54.0	0.0	0.0	0.0
Repurchases/repayments	3.2	7.4	23.1	24.4	24.7	21.8	28.3	16.5
Financing gap	0.0	0.0	0.0	0.0	48.5	42.4	0.0	0.0
IMF augmentation of access	...	...	...	...	48.5	...	...	...
Memorandum items:								
Gross official reserves	235.8	397.0	587.6	670.3	660.0	705.0	784.3	893.9
Months of imports[2]	1.2	2.0	3.1	3.4	3.2	3.3	3.4	3.6
Current account balance (percent of GDP)								
Excluding official transfers	-12.3	-10.0	-8.5	-8.6	-13.9	-8.7	-7.9	-7.7
Including official transfers	-9.3	-8.7	-8.5	-8.2	-13.9	-8.8	-8.0	-7.7
Import price index (2005 = 100)	144.1	142.3	138.3	118.5	107.7	112.7	114.9	134.7
Import volume (percent change)	-10.4	1.7	5.8	-1.9	9.0	-5.9	4.3	-0.3
REER (percent change)	-17.9	-14.9	8.8	14.3	...	...	...	...
Terms of trade (percent change)	-3.0	1.1	2.2	13.5	5.9	-4.6	-2.1	-3.0
Nominal GDP (millions of U.S. dollars)	5,980.6	5,432.2	6,055.3	6,410.1	5,767.1	6,825.5	7,355.2	7,822.9

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

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

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

Table 4b. Malawi: Balance of Payments, 2012–19
(Percent of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019
2-Jun-16	Act.	Est.	Est.	Est.		Proj.		
Current account balance (including grants)	-9.3	-8.7	-8.5	-8.2	-13.9	-8.8	-8.0	-7.7
Merchandise trade balance	-11.0	-8.1	-7.7	-7.0	-11.8	-7.0	-6.4	-6.3
Exports	21.3	27.6	25.8	23.2	26.9	23.8	23.6	23.7
Of which: Tobacco	8.0	8.0	7.8	8.1	9.5	8.3	8.1	8.1
Uranium	2.6	3.1	0.7	0.0	0.0	0.0	0.0	0.0
Imports	-32.3	-35.8	-33.5	-30.2	-38.7	-30.8	-30.0	-30.0
Of which : Petroleum	-2.9	-3.3	-3.0	-1.6	-1.5	-1.7	-1.8	-1.8
Maize					-4.1	-0.6		
Services balance	-5.6	-6.9	-5.9	-6.1	-7.5	-6.3	-5.8	-5.4
Interest public sector (net)	-0.2	-0.2	-0.1	-0.2	-0.6	-0.4	-0.3	-0.3
Other factor payments (net)	-2.1	-2.8	-2.5	-2.4	-2.4	-2.2	-2.1	-2.1
Nonfactor (net)	-4.1	-4.0	-3.2	-3.4	-4.4	-3.7	-3.4	-3.0
Transfers (net)	7.4	6.4	5.1	4.9	5.3	4.5	4.2	4.1
Private (net)	4.3	5.1	5.1	4.5	5.3	4.5	4.2	4.1
Official (net)	3.0	1.3	0.0	0.4	0.0	0.0	0.0	0.0
Receipts	3.0	1.3	0.0	0.4	0.0	0.0	0.0	0.0
Budget support	3.0	1.3	0.0	0.4	0.0	0.0	0.0	0.0
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account balance	6.9	8.0	4.3	4.1	8.8	5.3	4.9	4.8
Project and dedicated grants	6.9	8.0	4.3	4.1	8.8	5.3	4.9	4.8
Financial account balance	4.1	2.2	8.1	5.0	3.6	3.8	4.5	4.5
Medium- and long-term flows (net)	1.3	1.6	3.0	1.5	0.8	1.0	2.1	2.1
Loan disbursements	1.6	1.8	3.7	2.3	3.2	2.8	2.8	2.8
Budget support and other program loans	0.0	0.4	0.7	0.0	0.0	0.0	0.0	0.0
Project support loans	1.3	1.2	2.4	2.0	3.0	2.7	2.6	2.6
Other medium-term loans	0.3	0.2	0.6	0.3	0.2	0.1	0.1	0.1
Amortization	-0.3	-0.2	-0.7	-0.8	-2.4	-1.8	-0.7	-0.7
Foreign direct investment and other inflows	1.4	1.7	4.9	1.8	3.0	2.8	2.4	2.4
Commercial banks net foreign assets	1.4	-1.1	0.2	1.7	-0.2	0.1	0.0	0.0
Errors and omissions	-0.1	1.6	-1.2	0.0	0.0	0.0	0.0	0.0
Overall balance	1.6	3.1	2.7	0.9	-1.5	0.4	1.5	1.6
Financing	-1.6	-3.1	-2.7	-0.9	0.7	-1.0	-1.5	-1.6
Gross reserves (- increase)	-0.8	-3.0	-3.1	-1.3	0.2	-0.7	-1.1	-1.4
Liabilities	-0.8	-0.1	0.4	0.4	0.5	-0.3	-0.4	-0.2
Of which: IMF (net)	0.6	0.2	-0.1	-0.1	0.5	-0.3	-0.4	-0.2
Purchases/drawings	0.7	0.4	0.3	0.3	0.9	0.0	0.0	0.0
Repurchases/repayments	0.1	0.1	0.4	0.4	0.4	0.3	0.4	0.2
Financing gap	0.0	0.0	0.0	0.0	0.8	0.6	0.0	0.0
IMF augmentation of access					0.8			
Memorandum items:								
Gross official reserves	3.9	7.3	9.7	10.5	11.4	10.3	10.7	11.4
Current account balance (percent of GDP)								
Excluding official transfers	-12.3	-10.0	-8.5	-8.6	-13.9	-8.7	-7.9	-7.7
Including official transfers	-9.3	-8.7	-8.5	-8.2	-13.9	-8.8	-8.0	-7.7
Value of exports of GNFs (percent change)	0.9	16.6	4.8	-7.0	3.4	4.6	7.1	7.2
Value of imports of GNFs (percent change)	2.0	1.5	3.7	-4.8	14.0	-4.9	4.7	5.6

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

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

Key ratios	Dec-11	Jun-12	Dec-12	Jun-13	Dec-13	Jun-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Capital Adequacy											
1. Regulatory Tier 1 capital to risk weighted assets	16.5	16.2	16.4	16.1	16.2	14.9	13.5	16.1	15.0	13.7	12.7
2. Regulatory total capital to risk weighted assets	20.1	19.2	20.2	19.4	19.1	18.3	17.1	20.2	19.4	17.7	17.1
3. Total capital to total assets	14.6	13.9	14.3	15.1	15.4	17.9	17.6	20.3	16.6	18.2	16.9
Asset composition and quality											
1. Non-performing loans to gross loans and advances	4.1	5.5	9.4	12.6	15.4	16.1	14.9	14.8	13.8	11.6	10.7
2. Provisions to non-performing loans	36.9	30.5	26.8	30.5	29.1	28.3	31.8	33.4	34.7	30.5	28.3
3. Total loans and advances to total assets	52.7	53.3	50.8	45.4	40.5	42.1	40.3	43.3	41.0	40.1	39.3
4. Foreign currency loans to total loans and advances	6.1	9.4	7.9	10.5	13.5	18.1	19.1	21.4	16.1	24.1	28.7
Earnings and profitability											
1. Return on assets (ROA)	3.5	5.1	5.0	4.7	4.8	4.9	4.0	4.2	4.2	4.00	3.2
2. Return on equity (ROE)	24.7	36.7	36.9	36.2	37.5	33.5	26.8	25.0	24.9	24.6	20.1
3. Non-interest expenses to gross income	46.0	44.3	36.8	37.8	39.7	43.2	45.4	47.3	48.0	48.5	50.4
4. Interest margin to gross income	46.0	37.9	36.8	38.9	39.7	43.1	---	---	48.9	49.4	50.6
5. Non-Interest Income to Revenue			---	---	31.8	36	37.8	32.5	32.0	30.5	32.2
6. Net Interest Income to Assets			---	---	9.1	4.7	8.4	2.7	5.9	8.1	9.8
7. Personnel expenses to non-interest expenses	39.70	46.51	46.00	46.79	45.40	45.7	45.1	49.8	49.1	48.0	46.2
Liquidity											
1. Liquid assets to deposits and short-term liabilities	43.0	42.5	45.4	48.6	59.1	57.6	62.4	64.5	62.5	61.8	59.0
2. Total loans to total deposits	70.9	75.9	72.4	64.8	56.6	62.0	58.3	60.6	61.4	58.9	58.4
3. Liquid Assets to total assets	33.4	32.6	34.5	35.6	43.7	41.4	48.8	40.5	43.5	43.8	42.7
4. Foreign exchange liabilities to total liabilities	7.8	n.a.	17.9	n.a.	26.3	n.a.	---	---	16.1	---	

Source: Reserve Bank of Malawi.

Table 6. Malawi: External Financing Requirement and Source, 2012–19
(Millions of USD)

	2012	2013	2014	2015	2016	2017	2018	2019
Total requirement	-799	-715	-747	-684	-929	-764	-714	-760
Current account, excluding official transfer	-736	-543	-514	-552	-803	-597	-584	-600
Debt amortization	-17	-11	-42	-49	-137	-122	-51	-51
Gross reserves accumulation (- increase)	-46	-161	-191	-83	10	-45	-79	-110
Total sources	799	715	747	684	881	721	715	760
Expected disbursements (official)	684	603	485	437	690	549	562	589
Grants	590	506	260	289	505	359	359	374
Medium- and long-term loans	93	97	224	149	185	190	203	215
Private sector (net)	78	100	268	253	161	194	181	188
IMF (net)	37	13	-5	-6	29	-22	-28	-17
Drawings	40	20	18	18	54	0	0	0
Repayments	3	7	23	24	25	22	28	17
Financing gap	*0*	*0*	*0*	*0*	*48*	*43*	*0*	*0*
Gross official reserves	236	397	588	670	660	705	784	894
Months of imports	1.2	2.0	3.1	3.4	3.2	3.3	3.4	3.6

Source: IMF staff estimates.

Table 7a. Malawi: Previous Schedule of Disbursements under ECF Arrangement, 2012–16
(Millions of SDR)

Amount	% of Quota	Availability date	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.	Disbursed
6.51	9.38	September 15, 2014	Observance of performance criteria for June 30, 2014 and completion of sixth review.	Disbursed
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		
Memorandum item:				
Malawi's Quota (millions SDR)		69.4		

Source: IMF staff estimates.

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

(Millions of SDR)

Amount	% of Quota[1]	Availability date	Conditions Necessary for Disbursement	Status
13.02	9.38	July 23, 2012	Executive Board Approval of Three Year ECF arrangement.	Disbursed
13.02	9.38	December 15, 2012	Observance of performance criteria for September 30, 2012 and completion of first review.	Disbursed
13.01	9.37	March 15, 2013	Observance of performance criteria for December 31, 2012 and completion of second review.	Disbursed
6.51	4.69	June 15, 2013	Observance of performance criteria for March 31, 2013 and completion of third review.	Disbursed
6.50	4.68	December 15, 2013	Observance of performance criteria for September 30, 2013 and completion of fourth review.	Disbursed
6.51	4.69	March 15, 2014	Observance of performance criteria for December 31, 2013 and completion of fifth review.	Disbursed
6.51	4.69	September 15, 2014	Observance of performance criteria for June 30, 2014 and completion of sixth review.	Disbursed
9.76	7.03	September 15, 2015	Observance of performance criteria for June 30, 2015 and completion of the seventh review	
44.46	32.03	March 15, 2016	Observance of performance criteria for December 31, 2015 and completion of the eighth review [2]	
19.5	14.05	October 15, 2016	Observance of performance criteria for June 30, 2016 and completion of the ninth review.	
138.8	100	Total for the ECF arrangement		
Memorandum item:				
Malawi's new Quota (millions SDR)		138.8		

Source: IMF staff estimates.

[1]Using Malawi's current quota after effectiveness of the 14th General Review of Quotas.

[2]The amount includes an augmentation of 25 percent of quota (SDR34.7 million).

Table 8. Malawi: Indicators of Capacity to Repay the Fund, 2016–27

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Projected Payments based on Existing Drawings:												
(SDR millions)												
Principal	17.6	15.7	20.4	11.9	13.8	13.0	13.0	6.5	3.9	1.3	0.0	0.0
Charges and interest	0.04	0.03	0.01	0.14	0.11	0.08	0.04	0.02	0.01	0.00	0.00	0.00
Projected Payments based on Prospective Drawings:												
(SDR millions)												
Principal	0.0	0.0	0.0	0.0	0.0	5.4	10.8	10.8	10.8	10.8	5.4	0.0
Charges and interest	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Projected Payments based on Existing and Prospective Drawings:												
SDR millions	17.6	15.7	20.4	11.9	13.8	15.0	24.0	14.3	11.7	9.1	5.4	0.0
US$ Millions	24.4	21.8	28.3	16.6	19.2	20.9	33.4	19.9	16.3	12.7	7.6	0.0
Percent of exports of goods and services	1.5	1.2	1.5	0.8	0.9	0.9	1.3	0.7	0.6	0.4	0.2	0.0
Percent of debt service	23.5	24.4	28.4	18.4	20.2	21.3	28.5	16.8	11.6	8.0	4.3	0.0
Percent of quota	12.7	11.3	14.7	8.6	9.9	10.8	17.3	10.3	8.4	6.6	3.9	0.0
Percent of gross official reserves	3.7	3.1	3.6	1.9	1.9	1.9	2.8	1.6	1.2	0.9	0.5	0.0
Projected Level of Credit Outstanding based on Existing and Prospective Drawings:												
SDR millions	139.9	131.1	117.6	105.8	92.0	73.5	49.7	32.3	17.6	5.4	0.0	0.0
US$ Millions	195.6	183.5	164.9	148.7	129.5	103.4	69.9	45.4	24.7	7.6	0.0	0.0
Percent of exports of goods and services	11.7	10.5	8.8	7.4	5.9	4.5	2.8	1.7	0.9	0.2	0.0	0.0
Percent of debt service	188.6	205.0	165.3	165.4	135.7	105.6	59.4	38.3	17.6	4.8	0.0	0.0
Percent of quota	100.8	94.5	84.8	76.2	66.3	53.0	35.8	23.3	12.7	3.9	0.0	0.0
Percent of gross official reserves	29.6	26.0	21.0	16.6	13.0	9.5	5.9	3.6	1.8	0.5	0.0	0.0
Memorandum items:												
Exports of goods and services (millions of U.S. dollars)	1670	1747	1872	2006	2177	2311	2497	2670	2856	3094	3352	3632
Debt service (millions of U.S. dollars)	103.7	89.5	99.7	89.9	95.4	97.9	117.5	118.5	140.8	157.7	174.9	171.5
Quota (SDR millions)	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8
Gross official reserves (millions of U.S. dollars)	660.0	705.0	784.3	894.0	999.7	1093.2	1192.0	1276.6	1358.2	1392.8	1471.8	1607.8
GDP (millions of U.S. dollars)	5767	6826	7355	7823	8354	8931	9557	10220	10950	11745	12581	13491

Source: IMF staff projections.

Table 9a. Malawi: Quantitative Targets, 2015[1]

	Target type [2]	End-June 2015				End-Sept 2015 (IT)				End-Dec 2015			
		Prog.	Adjusted Prog.	Act.	Status	Prog.	Adjusted Prog.	Act.	Status	Prog.	Adjusted Prog.	Act.	Status
I. Monetary targets (millions of kwacha)													
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	87,033	93,063	39,169	Met	73,959	33,594	39,032	Not met	83,792	30,139	-70,410	Met
2. Ceiling on reserve money[3]	IT	243,828	243,828	213,046	Met	248,213	248,213	198,144	Met	260,545	260,545	198,144	Met
II. Fiscal targets (millions of kwacha)													
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	37,030	43,060	94,297	Not met	40,407	32,850	7,329	Met	58,162	51,489	4,269	Met
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	257,430		281,141	Met	54,725		65,132	Met	146,687		140,876	Not met
III. External sector targets (US$ millions, unless otherwise indicated)													
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	487	472	536	Met	531	549	500	Not met	537	522	489	Not met
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0		0	Met	0		0	Met	0		0	Met
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0		0	Met	0		0	Met	0		0	Met
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0		0	Met	0		0	Met	0		0	Met
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9]	PC				Met				Met				Met
Memorandum items:													
Net foreign assets of the RBM (US$ millions)		390		433		433		396		440		416	
Budget support (US$ millions)		18.07		0		0		26.6		7		26.6	
Budget support (millions of kwacha)		8000		0		0		17,982		3,224		17,982	
Debt service payments to the World Bank andAfDB (US$ millions)		12.12		12		3.90		1.7		7.80		3.0	
Debt service payments to the World Bank and AfDB (millions of kwacha)		4,872		4872		1,568		683		3,136		1206	
Health SWAp receipts (millions of kwacha)		15,668		11,939		2,114		0		14,993		0	
Education SWAp receipts (millions of kwacha)		3,384		2,594		0		0		0		0	
NAC receipts (millions of kwacha)		0		478		164		5,649		332		231	
Program exchange rate (kwacha per US$)		402				402	402	402		402		402	

Source: IMF staff projections.

[1]Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks unless otherwise specified.

[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 9b. Malawi: Quantitative Targets, 2016[1]

	Target type [2]	End-June 2016			
		Prog.	Adjusted Prog.	Act.	Status
I. Monetary targets (millions of kwacha)					
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	-90,331			
2. Ceiling on reserve money[3]	IT	176,413			
II. Fiscal targets (millions of kwacha)					
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	38,000			
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	292,675			
III. External sector targets (US$ millions, unless otherwise indicated)					
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	473			
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0			
7. Ceiling on non-concessional external debt [9,10]	PC	77.5			
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, end of period)		381			
Budget support (US$ millions)[7]		26.60			
Budget support (millions of kwacha)		20,528			
Nominal external concessional borrowing (US$ millions)[11]		150			
Debt service payments to the World Bank and AfDB (US$ millions)[7]		11.45			
Debt service payments to the World Bank and AfDB (millions of kwacha)		8,015			
Health SWAp receipts (millions of kwacha)[7]		14,993			
Education SWAp receipts (millions of kwacha)[7]		0			
NAC receipts (millions of kwacha)[7]		3,850			
Program exchange rate (kwacha per US$)		700			

Source: IMF staff projections.

[1]Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks unless otherwise specified.

[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.

[10]The ceiling comprises US$55 million from the AfDB for a water project and US$22.5 million from China for an e-government project.

[11]Concessional borrowing during the first half of fiscal year 2016/17.

Table 10a. Malawi: Structural Benchmarks for the 7th and 8th Reviews, 2015–16

Measures	Target date	Macro Rationale	Status
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.	Met
Reconcile all government bank accounts MG1 and six operational accounts and ways and means for all FY2014/15 transactions signed by the Accountant General and Secretary of the Treasury.	End-Feb 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Not met
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-Dec 2015	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Not met
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.	Not met
Produce and publish monthly summary bank account control reports.	End-September 2015	To improve transparency and control.	Not met
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.	Not met
Issue a report by an International firm confirming the status of implementation of forensic audit recommendations in the PFM domain.	End-Feb 2016	Foster greater transparency.	Not met
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.	Met
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.	Met
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.	Met
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.	Met
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.	Not Met
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.	Met
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.	Met

Source: IMF staff and Malawian authorities.

Table 10b. Malawi: Prior Actions for the 7th and 8th Reviews and Structural Benchmarks for 2016

Measures	Target date	Macro Rationale	Status
Prior Actions for completion of the seventh and eight reviews			
Reconcile all government bank accounts in MG1 and five operational accounts and ways and means for all FY2015/16 transactions (until end-December 2015). Have the completed reconciliations signed by the Accountant General and the Secretary of the Treasury		To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Pending
Prepare a report on the flow and stock of arrears at end-2015.		To monitor emergence of arrears.	Met
Structual Benchmarks			
Public financial management			
Publish detailed monthly budget execution data by vote for the first nine months of FY2015/16 on the Ministry of Finance's website.	End-June 2016	To foster greater fiscal transparency and monitoring.	
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-June 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	
Reconcile the wages account for the first six months of FY15/16.	End-June 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	
Reconcile all government bank accounts in MG1 and six operational accounts and ways and means for all FY2015/16 transactions (July 1, 2015 through June 30 2016). Have the completed reconciliations signed by the Accountant General, the Auditor General, and the Secretary of the Treasury.	End-August 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	
Auditor General to produce and publish an interim audit report covering July 1, 2015 to December 31, 2015.	End-Sept. 2016	To improve transparency and control.	
Issue a report by an International firm confirming the status of implementation of forensic audit recommendations in the PFM domain including controls over bank reconciliations for MG1 and six operational accounts and ways and means for the first half of FY15/16 transactions.	End-Sept. 2016	Foster greater transparency.	
Financial sector			
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 2016	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.	

Sources: IMF staff and Malawian authorities.

Letter of Intent

June 2, 2016

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

Dear Madam Lagarde:

1. On March 23, 2015, the Executive Board of the International Monetary Fund (IMF) completed the fifth and sixth reviews under the three year Extended Credit Facility (ECF) arrangement for Malawi and extended the arrangement to May 2016. 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 2015/16 as well as over the medium term.

2. Following the last Board meeting, program implementation initially suffered from policy slippages that prevented the completion of the seventh review, but these have now been corrected. In particular, we missed the end-June 2015 performance criterion (PC) on net domestic financing by a large margin. Most programmed public financial management reforms were not met. However, we made good progress with structural reforms in the financial sector.

3. Since that time, however, the momentum of our reform process has increased considerably. In particular, net domestic financing at end-December 2015 was contained substantially within the program's ceiling. This improvement was facilitated by the institution of commitment controls mandating that spending units submit detailed monthly fiscal reports as a condition for receiving regular funding. All other PCs for end-December 2015 were also met except that for net international reserves. At the same time, we have kept monetary policy tight and improved our policy framework by better aligning the interbank rate with the policy rate. We strongly believe that the appropriate adjustments in monetary and fiscal policies are having their intended effects as underlying non-food inflation has declined for the fifth consecutive month. With support from the Fund and other development partners, we have also made good progress in strengthening our public financial management system. We have prepared a report on the stock and flows of domestic arrears at end-2015 as prior actions for completion of the seventh and eight reviews.

Bank reconciliations for our main government account and five of the six operational accounts for the first half of FY15/16 are pending.

4. We remain committed to the objectives of the original ECF arrangement, 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 keep monetary and fiscal policies tight to reduce inflation. Our revised fiscal program for FY2015/16 has been approved by parliament and is in line with the program, and we have reached agreements with your staff on the broad contours of the FY16/17 fiscal framework. With donor assistance, we have also responded to the humanitarian needs of some 2.8 million Malawians. However, the program faces elevated risks arising from the prolonged effects of the El Niño-induced drought, including that we now face potentially higher costs of providing more humanitarian assistance and replenishing depleted grain stocks in the context of region-wide food insecurity.

5. We are requesting waivers for the nonobservance two periodic performance criteria. The performance criterion (PC) on net domestic borrowing was missed at end-June 2015 due mainly to the unplanned recruitment of teachers, revenue shortfalls, and unbudgeted wage increases. We are requesting a waiver for this on the basis of the strong remedial actions we have since taken to bring domestic borrowing back on track and into conformity with the end-December 2015 target. The PC on net international reserves was missed at end-December 2015 because of the effects of the El Niño-induced drought on exports and a strengthening of the dollar relative to the currencies of our region. We request a waiver for this on the basis of the tightening of our policy stance. At the same time the flexible exchange rate regime continues to serve us well in responding to external shocks.

6. 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 seventh and eighth reviews under the ECF arrangement and release the eighth and ninth tranches totaling SDR 19.52 million. We also request an extension of the arrangement by 6 months to end-December 2016 to allow for the completion of the ninth review. We also request an augmentation of access of 25 percent of quota under the program to respond the El-Niño-induced shock.

7. We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but we will take any further measures that may become appropriate for this purpose. We will consult with 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.

8. 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.

Memorandum of Economic and Financial Policies June 2016

BACKGROUND

1. **This memorandum supplements the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent** dated March 4, 2015, and describes recent developments and performance under the ECF arrangement since completion of the fifth and sixth reviews in March 2015. 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. **The Government, led by His Excellency Professor Arthur Peter Mutharika, remains 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. Over the six months immediately following the conclusion of the fifth and sixth reviews some policy slippage occurred, that delayed program implementation. However, these have now been corrected and policy, both in the macroeconomic area and in our ambitious structural agenda, is now back on track. We intend to vigorously implement all the policy commitments set out in this memorandum, as evidenced by our completion of the prior actions in the public financial management (PFM) area. We also remain committed to the fundamental reforms adopted in 2012 that established a flexible exchange rate and cost recovery based fuel pricing mechanism, as we view these as necessary and appropriate to Malawi's present economic circumstances.

3. **The risks to the program have risen as the drought has continued for a second consecutive year.** On April 12, 2016 we announced a state of national disaster as the prolonged effects of the drought, which has already affected 2.8 million persons, is expected to place an estimated 8.4 million people at risk of food insecurity in the near term. The scale of the humanitarian needs had increased and the costs of procuring maize had risen owing to the region-wide effects of the drought and the possible necessity of importing some maize from outside the continent. Preliminary estimates of the maize deficit are about 1.1 million metric tons. Of this amount about 790,000 metric tons will be allocated to provide relief to the affected population and the remainder to replenish the strategic grain reserves and to stabilize prices. The total cost of the humanitarian efforts is estimated at about US$276 million. We have appealed to our development partners to assist with financing the humanitarian relief and are requesting IMF assistance through an

augmentation of access equivalent to 25 percent of quota. The requested augmentation will facilitate additional maize purchases by the Malawian government to contribute to the humanitarian relief.

RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM OUTLOOK

Recent Economic Developments

4. Weather-related shocks negatively impacted our growth in 2015 and, combined with some policy slippage, contributed to an uptick in inflation:

- **Real GDP grow this estimated to have declined by 2.7 percentage points to 3 percent in 2015.** Heavy floods and drought during the first quarter of the year decreased overall agricultural production by 1.5 percent of which the staple maize crop declined by 28 percent. This had negative impact on the manufacturing and trade sectors, which was only partially mitigated by relative good outturns in the information and communication, accommodation, and food service sectors.

- **Inflation**, after declining by 6 percentage points from end-2014 to 18 percent in March 2015, rose steadily to 24.9 percent at end-December2015, led by rising food prices and a sharp depreciation of the kwacha. Excessive domestic borrowing at this time was also a contributing factor. Inflation subsequently fell somewhat up to February 2016 but, at 23.4 percent, remained substantially above its level of a year ago. This was due, mainly however, to supply side effects, in particular the persistence of food inflation related to the poor harvest and low level of domestic supply. Core inflation—as measured broadly by the non-food component of the CPI basket—has been on a clear declining trend for the last five months, implying that our renewed commitment to appropriately calibrated demand management policies are beginning to have their intended effect.

- **We have largely met the needs of the 2.8 million people who were put in positions of food insecurity as a result of the poor maize harvest in 2015.** A major operation, coordinated by the World Food Program was launched at a cost of US$111 million, and later raised to US$127 million after the full extent of the situation became apparent. The Government of Malawi provided about US$22 million in funding, in cash and in the form of maize from our Strategic Grain Reserves (SGR), with the remainder generously provided by the donor community. This proved sufficient to meet basic needs up to the start of the 2016 harvest at end-April. While we are pleased with the relatively successful outcome of the operation, it has left us in a vulnerable position—our SGR is virtually exhausted, fiscal space is limited, and the countries that make up our traditional sources of imports are themselves being pressed on food security and are increasingly reluctant to export.

5. Budget execution suffered in latter part of the last fiscal year, but firm control was regained by the first half of FY15/16 (July to December):

- **In the period leading up to June 2015, tax and external financing shortfalls, and an unplanned recruitment of 10,500 teachers temporarily derailed our fiscal program.** While we took corrective expenditure measures of about ¾ percentage points of GDP, and benefited from almost ½ percentage points of GDP of unanticipated one-off nontax revenues, total domestic borrowing by the end of FY 2014/15 still exceeded our target by 2 percentage points of GDP.

- **However, by the end of the first half of FY 2015/16, we had regained firm fiscal control.** Revenues since December 2015 were marginally lower than projected, but we have exercised firm compensatory control over spending even when revenues have been much lower than anticipated. For example, we are now requiring detailed monthly fiscal reports from all spending units as a condition for the subsequent month's funding, and have withheld funding from some for noncompliance. As a result, net domestic financing for the first half of the 2015/16 fiscal year was held at a much lower level than programmed. In this process, we did miss our end-December 2015 indicative target (IT) on social expenditure (the outturn was MK140.9 billion compared with MK146.7 billion programmed). This was mostly due to a logistical delay in spending on the Farm Input Subsidy Program (FISP).

6. **We conducted a payroll audit to strengthen control over the wage bill** with donor funding. The payroll audit revealed a number of weaknesses in internal controls in management of the wage bill. We have since taken measures to deal with the weaknesses identified by (i) eliminating ghost workers; (ii) stopping illicit editing of the salary schedule; (iii) ceasing overstating salary funding; and (iv) eliminating employees beyond the retirement age. We also concluded a headcount in April 2016, which revealed that an estimated 10 percent of the labor force of 177,000 employees needed further tracking to establish their authenticity. We resolved to remove all the suspected employees from the payroll and examine their cases as they come forward to present them.
Of these, an extricated 2,300 are unquestionably physically non-existent in the system.
These measures are expected to result in a reduction in the wage bill by an estimated amount of MK4.1 billion this fiscal year.

7. **The auditing of old arrears has now been completed and incorporated into our fiscal framework.** Of the MK157 billion (6 percent of GDP), MK72 billion have been verified as legitimate arrears, MK30 billion were rejected due to the absence of supporting documentation and the remaining MK55 billion require additional documentation from Ministries, for which we have fixed a deadline of end-June, 2016. Regarding bone fide arrears, we have issued zero coupon bonds with one to three year maturities and have implemented reporting procedures to mitigate the emergence of new arrears.

8. **Similarly, we have now tightened monetary policy after the LRR was halved in July 2015.** In July 2015, the liquid reserve ratio (LRR) was cut in half. This measure was aimed at reducing banks' costs and thereby encouraging lower interest rates as a stimulus to bank lending and higher economic activity. Since then, we have absorbed the liquidity expansion from the change in the LRR and kept monetary conditions very tight. As a result, short-term interest rates have risen and are now positive in real terms, while liquidity in the interbank market has been markedly contained.

9. **The exchange rate depreciated significantly during the second half of 2015 up to early March, but is now appreciating.** The Kwacha depreciated by more than 34 percent from July 2015 to early March 2016, a trend broadly mirroring that of neighboring countries. It is likely that deteriorating expectations—including when our ECF arrangement went off-track—and the liquidity expansion of July 2015 following the LRR reductions also played a role in this. We intervened more than programmed to smooth volatility at various times but, on the whole, largely allowed the depreciation to run its course. In this manner, we managed to hold our reserve cover close to 3 months of imports.

10. The situations in both the interbank and foreign exchange markets have now improved significantly:

- Interbank rates have responded to the less liquid conditions and are now close to the policy rate of 27 percent, quite positive in real terms. To reduce volatility, we have introduced a deposit facility, set at 2 percentage points below the policy rate. Together with a Lombard facility at 2 percentage points above the policy rate, this establishes an interest rate corridor of +/- two percent around the policy rate—25 to 29 percent at current values. We expect the combination of these two facilities to help us keep the interbank rate close to the policy rate, and establish a true and binding opportunity cost of money. With the corridor rising and falling with changes in the policy rate, we would also expect a significant improvement in the monetary transmission mechanism, and hence more effective and efficient monetary policy.

- Partly in response to the tightened liquidity conditions, and also because of the beginning of the tobacco purchase season, the exchange rate has now strengthened, and up to May 2016 has regained 5.7 percent of its value. On the strength of this, we have also managed to purchase additional reserves in the market, and our stock now stands at 3.0 months of import cover as of May 2016.

PERFORMANCE UNDER THE PROGRAM

11. Our ECF arrangement suffered setbacks in the run-up to the seventh review, as a result of fiscal overruns and delays in implementing structural measures. Both net domestic assets (NDA) and net international reserves (NIR) of the Reserve Bank of Malawi (RBM) at end-June were met, but net domestic financing (NDF) was missed by a large margin (2 percent of GDP). The overrun on NDF was mainly due to the unplanned recruitment of teachers, unbudgeted wage increases, and revenue shortfalls. The remaining quantitative performance criteria (PCs) and indicative targets (ITs) were met, and good progress was made in implementing structural benchmarks (SBs) related to the financial sector. However, all PFM-related structural benchmarks—the cornerstone of our structural agenda—were missed.

12. Following this setback, and after witnessing a rebound in inflation due in part to the expansion of NDF, we re-committed ourselves to achieving our program goals. To this end, beginning in early FY 2015/16, we contained expenditure and reined in banking sector liquidity. As a result, by end-December 2015, NDF had been held well below the program target, despite widespread demand to expand expenditure in the face of what is undeniably strong domestic need. We resisted these pressures because we believe reducing inflation will bring greater benefits to the population as a whole and to vulnerable groups in particular, than would sporadic increases in government expenditure regardless of the efficiency with which it is executed. However, while we largely allowed the exchange rate to depreciate to adjust to a changing external environment, the effect of lower-than-expected export revenues, the need to carry out some limited smoothing in the foreign exchange market, and an unanticipated regional shift in preferences away from domestic currencies nonetheless pushed our reserve levels below program targets and we missed the NIR target for end-December 2015. Against this background, we are requesting a waiver for non-attainment of the December 2015 PC floor on NIR on the basis that we permitted a large depreciation in line with program understandings on the exchange rate regime. We are also requesting a waiver for the breach of the end-June 2015 program ceiling on NDF on the strength of the remedial actions we have taken since that time and our compliance with the end-December 2015 target.

13. The pace of implementation of PFM measures under the program faltered after the conclusion of the fifth and sixth reviews, but has since accelerated significantly:

- Bank reconciliation initially proved difficult to effect. However, as a prior action (PA) for completion of the seventh and eight reviews, we have now completed monthly reconciliations for the first six months of the 2015/16 fiscal year for our main government account (the MG1 account) and five of the six operational accounts. Reconciliation of the remaining operational account—the wage and salary account—was delayed for technical reasons, but is expected to be completed by end-June 2016. Progress in reconciliation was slow at first due to the need to fully account for (i) revenues received at the Bank but not captured in IFMIS in real time (ii) FY 2014/15 payments recorded in FY 2015/16, (iii) un-presented checks, (iv) system problems where processed transactions were not updating the cash book in IFMIS, (v) foreign payments made by the RBM on behalf of Government but not recorded in IFMIS, such as public debt transactions, and (vi) funding not done in both systems i.e. TIBCO and IFMIS. Human error and omissions also needed to be accounted for. Resolving these sources of discrepancy took time, but solutions were eventually found that allowed full reconciliation to take place. The process was assisted with the help of a PFM resident advisor supplied by the Fund. Government is making progress towards capturing all expenditures of Government in the IFMIS system by end April 2016—a major step forward—and the monthly reconciliations between these book records and bank statements now constitute a strong safeguard against theft of government funds. They also help provide a needed and welcome assurance that an event such as Cashgate is unlikely to be repeated. The reconciliations for the first half of FY 2015/16 have been verified by the Secretary to Treasury and the Accountant General. The wages account was excluded from the reconciliation of the six operational accounts (prior action) for technical reasons related to five electronic platforms that are not interconnected. To reaffirm our commitment the reconciliation of this account has been set as a benchmark for end-June. We will use these reconciled bank statements to produce an interim audit report by the Auditor General of the first six months of FY 2015/16 and publish this report on the Ministry of Finance web site by end-September 2016 (SB). Going forward, we will continue to produce bank reconciliations on a monthly basis with a lag of no more than four weeks (SB).

- **To further improve fiscal control and accountability, we have also, as a PA, issued a report on the quarterly flow and stock of domestic payment arrears.** These reports, prepared for end-September 2015, and end-December 2015indicate only a marginal accumulation of new domestic arrears, which provides strong assurance that our control over fiscal expenditure is significantly improved from past years. Despite the small volumes of new arrears, we are, nonetheless, actively investigating how each one arose, with a view to normalizing the entire stock quickly and efficiently. Going forward, we will continue to produce quarterly reports on the flow and stock of domestic arrears with a lag of no more than two months (structural benchmark).

- **Other PFM reforms have also advanced.** To further fiscal transparency, we have begun publishing detailed monthly budget execution data by vote on the Ministry of Finance web site. To date, monthly data for July 2015 to February 2016 have been posted. We have finished reviewing all government bank accounts and, in the process, closed over 282 redundant and dormant accounts. We are pushing ahead with fiscal accountability. We continue to prosecute persons accused of perpetrating the Cashgate scandal, using evidence collected by the forensic audit for the period 1st April 2013 to 30 September 2013, and the results of the investigations of the Directorate of Public Prosecutions and the Anti-Corruption Bureau. To date, 9 cases have been prosecuted—all successfully—and 11 perpetrators have been convicted, receiving sentences of between 3 and 10 years. Looking ahead, we will expand the range of prosecutions, based on existing case files, and with the results of a new forensic audit. This audit, financed with assistance from the German Government, will examine all fiscal records from January 1, 2009–December 2014, and this auditor has also been commissioned to prepare banks reconciliations for this period. We intend to evaluate prosecutable opportunities once this report is submitted.

- **In the financial sector, most measures covered by structural benchmarks have been met, albeit some with delay.** To safeguard financial sector stability we prepared a strategy to address banking sector wide issues raised by the third-party diagnostic assessments, we obtained detailed remediation plans from all undercapitalized banks, we developed plans for all banks to correct reporting deficiencies within one year, and the RBM produced a detailed report on compliance with regulations on loan classification and provisioning and concentration limits in line with existing directives. To improve the resolution framework, the RBM developed contingency plans to intervene and resolve banks that do not submit or comply with acceptable recapitalization plans. In the area of improving the AML/CFT regime in Malawi, we have not yet submitted to Parliament amendments to the AML/CFT Act, the Penal Code, and the Corrupt Practices Act. These were subjected to significant discussion and revision, and we did not meet the deadline for submission to this parliamentary session. However, we will submit them in the next session that begins in June 2016 and will ensure that they are fully in line with the FATF standard and the United Nations Convention against Corruption.

KEY ECONOMIC OBJECTIVES, OUTLOOK AND RISKS

14. **The macroeconomic outlook remains challenging in light of continued uncertainties related to weather conditions, uncertain financing possibilities, and the persistence of high inflation.** Medium-term projections are predicated on policy actions being taken to reduce inflation, on the normalization of weather conditions, and on progress made in addressing key supply-side bottlenecks. These policies, combined with retention of the flexible exchange rate and the automatic fuel pricing regimes as valuable shock absorbers, are expected to foster a gradual increase in private sector confidence needed to re-ignite investment spending.

15. **Our short-term objective is to stabilize our macroeconomic situation, regain control over our fiscal systems, and safeguard external and financial sector stability.** These goals, largely unchanged from our original program, remain necessary conditions that need to be met if we are to build a solid foundation for reducing poverty and addressing Malawi's development needs in the years ahead.

16. **Responsible fiscal and monetary policies, combined with vigorous PFM reform, will continue to be implemented to reduce inflation, reverse the contraction of real incomes, and restore confidence in the budget process.** We believe that achieving price stability, and demonstrating a strong ability to control fiscal spending, and adhere to a responsible fiscal strategy, will boost private sector confidence. This would be reinforced by clear wins in public financial management. As confidence returns, and as our business environment improves—including through a decline in bank lending rates in lagged steps with inflation—we would expect investment levels to rise sufficiently to promote significant growth-enhancing investment over the medium term. We would also anticipate a rebound in consumption demand, once the real income-eroding effect of high inflation on household spending is mitigated by our disinflation program.

17. **With restrictive financial policies in place throughout 2016, and the negative impact of El Niño, growth will remain subdued this year.** The increase in real GDP is therefore unlikely to exceed 4 percent in 2016. However, inflation should decline to about 16 percent (year-on-year) by end 2016. The effect of sustained high interest rates—which will increase the attractiveness of holding kwacha-denominated assets—and another good tobacco purchasing season will strengthen net foreign currency inflows, and we expect foreign exchange reserves to remain at 3 months of import cover.

18. **As confidence and investment and consumption levels rise, we would expect an improvement in economic activity in 2017 and beyond.** With rising investment, real growth in

2017 could reach 5.5 percent, before gradually increasing to around 6 percent in the medium term. Inflation will decline to single digits by the end of 2017. The tight fiscal stance over this period will also improve our debt sustainability position, and we expect domestic debt as a share of GDP to be placed on a declining trend over the medium term. We recognize, however, that this goal will require strengthening of our debt management capacity.

19. **Short-term risks are tilted to the downside as the looming food crisis—aggravated by the El Niño weather phenomenon—will weigh heavily on the outlook.** Additional downside risks could arise from slippages in macroeconomic policy implementation, but we will remain vigilant against these as they would place further pressure on the kwacha and dampen public and private financial inflows. The requested augmentation of access under the ECF arrangement will help us in responding to the looming humanitarian crisis. We are actively engaged with donors to mobilize urgent humanitarian assistance.

POLICIES

Monetary and Financial Sector Policies

20. **We are determined to use monetary policy to keep inflation on a declining trajectory.** Recent efforts to further tighten our monetary policy stance, and the supportive fiscal measures adopted during the first half of this fiscal year, have helped to reduce inflation pressure despite the rise in food prices following climate-related shocks. Our monetary policy will aim at attaining an end-of-period inflation rate of 16 percent by December 2016, and to maintain a minimum of 3 months import cover in foreign exchange reserves. Tight monetary policy will be kept in place by ensuring that the central bank rate remains well above the rate of inflation and by using liquidity operations in the interbank and Treasury bill markets to maintain positive real interest rates in our financial system. The recently introduced deposit facility will help contain overnight money market deviations from the policy rate to +/- 200 basis points.

21. **We will continue to strengthen our monetary policy framework.** We will improve communication with stakeholders and the general public, which will raise policy credibility, increase the efficiency of policy transmission, and better anchor inflation expectations. Policy credibility will be further enhanced by full adherence to the amended RBM Act. The September 2015 amendments limit the possibility for fiscal dominance by establishing an upper bound of 10 percent of the previous year's revenue on total government advances. Supported by greater fiscal discipline and improvements in our PFM systems, we anticipate that our policy framework and policy execution will be sufficient to lower inflationary expectations over time. Maintenance of positive real interest rates

will also increase demand for holding kwacha, and eventually help to mitigate the seasonal depreciation pressure that typically appears in the lean season when foreign currency inflows are low. 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.

22. **We are committed to developing an interest rate-based monetary policy framework.** Our current monetary targeting framework, with an operational target on the level of reserve money and a floor on NIR stocks, will be maintained for the remainder of our ECF arrangement. However, within this framework, we intend to allow interest rates to play a significantly expanded role. Our recent establishment of an interest rate corridor in the interbank market—facilitated by the deployment of an overnight deposit facility—should yield significantly greater RBM control over the interbank rate. We expect this, when applied consistently, to yield increasing control over longer term rates and gain us influence over the entire interest rate structure of the market. This will add significantly more relevance to the policy rate, reduce interest rate volatility, and improve the monetary policy transmission mechanism. We intend to continue expanding our capacity in this regard, with one aim being the eventual adoption of a full-fledged inflation targeting regime in the medium-term. Developing such a framework will require continued upgrading of skills in liquidity forecasting and control, a deeper understanding of monetary transmission mechanisms, and greater inflation forecasting capacity, including through economic modeling. We look to the IMF as a source of technical assistance in these areas.

23. **We will combine tight monetary conditions with efforts to safeguard financial sector stability by strengthening our supervision and resolution capacity.** Vulnerabilities in the banking sector were substantially reduced by the June 2015 sale of government's stake in two weak banks to other players in the banking system. A restructuring and integration of the two banks is proceeding under close monitoring from the central bank and is expected to be completed by December 2016. With Fund technical assistance, we adopted in May 2014 a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action against distressed banks. The PCA framework has been complemented with a model resolution framework that outlines the various options that could be taken to intervene and resolve any problem bank that fails to submit or comply with an acceptable recapitalization plan. We have also improved prudential norms in the areas of asset classification and provisioning. Our new asset classification directive, enacted in May 2014 and based on the estimated recoverable amount method (ERAM), imposes higher and graduated provisioning rates, and is expected to strengthen banking sector resilience and improve the ability to deal with adverse developments.

24. **Implementation of our new ERAM-based provisioning regulations has shifted the capital adequacy positions of two additional banks below the required standard.** We are working closely with these banks and have agreed remediation measures to correct this situation. One of the two banks is expected to be recapitalized by shareholders by end-June 2016. Discussions with a potential external buyer for the second bank are underway. The RBM is closely monitoring the recapitalization process.

25. **We are taking additional steps to strengthen banking supervision aimed at ensuring the continued stability of the financial system.** To this end, we are enhancing both on-site and off-site supervision, closely monitoring and enforcing compliance with all prudential norms and enhancing the supervisory skills of the staff of RBM. Loan concentration remains one of the major risk factors in our banking system. This risk has continued to rise due to the extension of large credits to a limited numbers of borrowers or to specific economic sectors and activities. As this could lead to challenges in liquidity and capital positions of banks, the RBM will continue to closely monitor loan concentrations in the banking sector.

Fiscal Policy

26. **Our fiscal policy stance will support the monetary policy objective of reducing inflation.** This will require that spending is kept within available resources, and that government's recourse to domestic borrowing, particularly from the RBM, is strictly limited, so that demand-pull inflation and second-round effects of recent food price increases are contained. Continued implementation of a tight fiscal policy is necessary over the medium term to keep public debt as a ratio to GDP on a downward trajectory, prevent government borrowing from crowding out the private sector, and avoid debt service costs replacing other, more productive, growth enhancing forms of government expenditure.

27. **To these ends, we used the mid-term budget review to fine tune our fiscal position for the remainder of FY 2015/16 to ensure conformity with program targets.** Excessive domestic borrowing during the second half of FY 2014/15 likely contributed to inflation exceeding the projection made at the time of the fifth and sixth reviews. As a result, nominal GDP in FY2015/16 is now somewhat larger than initially projected. However, our revised FY2015/16 budget, was based on keeping NDF at MK25 billion (0.7 percent of GDP) but will be revised upwards by 0.4 percent of GDP to accommodated additional maize purchases for humanitarian relief.

28. **We continue to prioritize revenue mobilization.** We recognize that budget support is becoming less likely, as donors are increasingly gravitating towards other forms of assistance.

We will therefore develop more reliable forms of resource mobilization, specifically by improving the efficiency of tax administration and through tax policy changes aimed at generating additional revenue. We are also developing a Dividend and Surplus Policy to enhance financial management in statutory bodies and ensure the transfer of these resources to the treasury.

29. **We are committed to implement broad based tax reforms starting from FY2016/17 with the aim of creating a simple, efficient, transparent and fair tax system.** To this effect, we are streamlining tax incentives, eliminating unproductive tax measures and broadening the tax base. Our tax policy initiatives will be guided by a shift in reliance on revenue from taxation of labor and investment (factors of production) to consumption. This shift of the relative tax burden from income to consumption should therefore help to spur economic development.

30. **We are also committed to implement efficient tax administration measures.** To support the tax policy initiatives enumerated above the Malawi Revenue Authority is undertaking a number of tax administration initiatives that will reduce tax compliance costs for both the tax-payer and the tax administrator, and thus enhance revenue collection in the 2016/17 Fiscal year. In this context, we are determined to implement the recommendations of the 2015 TADAT assessment.

31. **Our budget for FY 2016/17 will continue the process of fiscal and debt consolidation.** The NDF agreed under the program (one percent of GDP) will be revised upwards by 0.4 percent of GDP to permit additional maize purchases for the humanitarian relief. In terms of wage policy the budget will provide for annual wage creep as well as recruitment of frontline staff mainly in the Ministries of Education, Health and Natural Resources. A general increase of the wage bill at a rate lower than inflation will be implemented. The wage bill will be contained. With regard to FISP, the reforms implemented in the 2015/16 growing season are currently under review in light of the lessons learnt during the pilot phase. It is expected that findings from the pilot phase will inform program implementation in the 2016/17 financial year. Furthermore, the Government will ensure that austerity measures on the expenditure side and domestic revenue enhancing measures highlighted in paragraph 30 keep end of the 2016/17 FY domestic borrowing target consistent with monetary policies to reduce inflation. The ceiling on nonconcessional debt would be modified to accommodated two loans. US$55 million from the AfDB for a water project and US$22.5 million from China for an e-government project.

32. **The risks to the program have risen as the drought has continued for a second consecutive year.** On April 12, 2016 we announced a national disaster given the sharp decline in maize production which has already affected 2.8 million persons. The number of affected persons is likely to rise in the months ahead. Preliminary estimates of the maize deficit are about 1.1 million

metric tons. Of this amount about 790,000 metric tons will be allocated to provide relief to the affected population and the remainder to replenish the strategic grain reserves and to stabilize prices. We have appealed to our development partners to assist with financing the humanitarian relief but the Malawian government will be expected to contribute to these efforts.

Public Financial Management Reform

33. Our recent success in achieving bank reconciliation establishes a strong foundation on which to expand public financial management reforms. We have now started focusing on strengthening other areas such as the creation of a more reliable system for budget control and reporting. Since January 2016, monthly funding to ministries, departments and agencies (MDAs) has become contingent upon the submission of five reports, namely expenditure returns, revenue returns, commitment returns, bank reconciliation reports and payroll returns. This is assisting in recording and tracking commitments and arrears as they arise, among other uses. Compliance to this measure by MDAs has now reached almost 87 percent. Further, the success in bank reconciliations enables us to improve upon our financial reporting deadlines. We are now able to produce unaudited quarterly financial statements within six weeks after the end of the quarter, and are optimistic that the 2015/16 financial statements will be submitted to the Auditor General by 31st October 2016 as required under the Public Finance Management Act. The timely reporting will mean that Parliament will, from next year going forward start to discuss reports that are not only reliable but also relevant. The clearance of the backlog will also provide a good base for the implementation of the new IFMIS project that will be more robust, comprehensive and assist to address control weaknesses such as payroll management, project management, arrears and commitments, among others. Operations of the Cash Management Committee have been strengthened and we are initiating further cash management reforms.

34. **We are developing a medium term strategy that aims at solidifying the present gains.** In this regard, after full piloting over the past two fiscal years, we are introducing programme budgeting (PBB) across all MDAs. This is a significant reform that will improve resource allocation and overall public financial management in the country. We will also embark on building human capacity to ensure that the reforms being implemented are sustained. Institutionalization of induction training will also be a key component of the reforms. A review of the PFM Act has also commenced to ensure that laws and regulations are brought in line with the reforms that are taking place, with emphasis on a rewards and sanctions regime. Strengthening of oversight institutions such as the National Audit Office, Central Internal Audit Unit and the Public Accounts Committee will continue under the medium term strategy that is being developed.

Pension Reform

35. **We are committed to the reform of our public pension scheme to ensure its long-term fiscal viability.** Under the Pension Act of 2010, the Government was supposed to transform its defined benefit civil servant pension system into a defined contribution scheme. However, investigation—including with the help of IMF technical assistance—has determined that the size of the pension liability renders this fiscally untenable. Furnishing the scheme with the necessary reserves for it to operate as a defined contribution scheme would require issuance of assets exceeding 60 percent of GDP. Such asset transfers are beyond the means of the government and, in any event, could not be accommodated by nascent capital markets without severe disruption. Moreover, we have determined that even the existing defined benefit public pension scheme is not sustainable—in the absence of reserves commensurate to the scheme's liabilities, servicing accrued benefits would require disproportionately high budget subsidies.

36. We will therefore revisit the proposed pension reforms by concentrating on parameter adjustment to reduce the liabilities of the current system. These changes, which would bring the benefits and costs more in line with schemes in other countries, may include: (i) raising the service retirement age; (ii) lowering the generosity of benefit indexation; (iii) reducing accrual rates; and (iv) introducing a phased in approach of contribution to implementing public service public scheme contributions.

37. We believe that some migration to a defined contribution scheme for more recent hires and employees that are 30 years old and below might be fiscally feasible, but only if implemented gradually and with due consideration for fiscal and financial sector constraints.

Debt Management

38. **We take note of the IMF's new debt limits policy.** In conformity with this policy, we will limit our unified external borrowing to projects which are in line with program objectives and ensure that total contracted volumes are consistent with debt sustainability. As Malawi is at medium risk of debt distress with low debt management capacity, we will adhere to the limits on the nominal value of non-concessional (PC) and concessional borrowing (memo item) as indicated in our borrowing plan, which is outlined in Debt Sustainability Analysis.. This borrowing plan is consistent with our objective of social development and poverty reduction and with overall medium- to long-term debt sustainability.

39. **Given that Malawi still has low debt management capacity, we will strengthen our Debt Management framework.** We had intended to begin this process immediately following IMF

Board approval of the fifth and sixth reviews. However, we have only recently managed to fully operationalize our Debt Management Committee. Going forward, now that the Debt Management Committee is operational, it will look at each borrowing and ascertain its concessionality and ensure debt sustainability with the entire borrowing plan.

Fuel Import Regime

40. **We are taking necessary steps to improve our fuel security situation.** In the past, our fuel storage capacity has been limited to 14 days of supply held in idle tanker trucks. The low level of reserves, combined with our landlocked geographical status, clearly places us in a vulnerable position that we are highly desirous of mitigating. To this end, we have now completed construction of three fuel storage depots capable of holding about 25 percent of annual consumption.

41. **The new fuel storage reservoirs offer the possibility of greater assurance of fuel supply, but the management issues need to be carefully considered.** Our current fuel import regime—based on private sector importation with cost recovery guaranteed by the automatic fuel pricing mechanism—has worked well in the past, with supply on demand available since 2012. However, with the completion of the new fuel storage tanks, an additional dimension has been introduced, as a method is required to finance the accumulation of the needed fuel reserves. The challenge will be to amend the fuel import regime in a manner that utilizes the new fuel tanks without introducing new sources of risks.

42. **Over the next fiscal year, the fuel import regime will remain unchanged, while we carefully evaluate possible amendments aimed at enhancing security and efficiency.** To this end, we will examine ways and means of filling the new fuel tanks in a cost effective and transparent manner, taking full advantage of the technical assistance on offer from various donors, including the World Bank, for this operation. In this process, we will examine both private sector and public sector-led solutions, including the option of a government-run bulk procurement system. The discussion will be held in an open and transparent manner, with full participation of the private sector. In light of the possible macro-critical ramifications of changes in this key sector, we will produce, publish, and discuss with all interested parties a fully costed and well thought out proposal prior to implementation.

Program Issues and Monitoring

43. In order to allow completion of the seventh and eighth reviews, we are requesting waivers for non-attainment of two performance criteria. For the reasons noted above ., we are requesting a

waiver for the breach of the end-June 2015 program ceiling on NDF and end-December 2015 floor on NIR.

44. Going forward, we request that the Executive Board extend our ECF arrangement until end-December 2016, establish a ninth review with test date of end-June 2016, and establish performance criteria for end-June 2016. This extension will allow the entire FY 2015/16 budget year to be included in the program, which will assist us with execution, and also allow additional time under the program for the completion of additional and vital structural measures. We also request that the performance criteria formerly governing external debt accumulation be replaced with the formulation in Table 2, which incorporates the Fund's new debt limits policy. The ninth program review is expected to be completed on or after October 15, 2016.

Technical Memorandum of Understanding
June 2016

1. **This memorandum sets out the understandings between the Malawian authorities and the International Monetary Fund** regarding the definitions of quantitative performance criteria (PCs), 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 of PCs AND MEMORANDUM ITEMS

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, and National AIDS Commission (NAC) held in the Malawi banking system. Budget support is measured as a cumulative flow from the beginning of the 2015/16 fiscal year (on July 1, 2015) running to the end of the program period. 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 5.

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 700 = 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:

Table A. Program Baseline: Projected Budget Support, March–June, 2016
(Millions of USD, cumulative from the beginning of the 2015/16 fiscal year[1])

	Mar-16	Jun-16
Budget Support	26.6	26.6

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

- **Donor pool accounts for the social sectors,** including health and education SWAps, and the National AIDS Commission (NAC). Donor pool account inflows for the social sector will be measured cumulatively from the beginning of the 2015/16 fiscal year running to the end of the program period. 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–June, 2016[1]

(Millions of USD, cumulative from the beginning of the 2015/16 fiscal year[2])

	Mar-16	Jun-16
Donor inflows	15.3	16.0

[1] includes both loans and grants

[2] 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 2015/16 fiscal year running to the end of the program period. 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–June, 2016

(Millions of USD, cumulative from the beginning of the 2015/16 fiscal year[1])

	Mar-16	Jun-16
Debt service	7.3	10.5

[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.

10. **After applying the adjusters outlined in paragraphs 8 and 9, the program target on NIR will be subject to a further adjustment for the level of humanitarian spending.** The target on NIR will be adjusted downward by the amount of government spending above US$9 million used to purchase maize and other food items specifically to alleviate the current humanitarian crisis. For the purposes of this adjuster, eligible government spending will be defined as (i) the cost to government of maize and other foodstuffs purchased and transferred to the World Food Program (WFP) in Malawi for use in the WFP-administered food relief operations; and (ii) financial assets transferred to the WFP in Malawi for use in WFP-administered food relief operations, including cash transfers to relief recipients. This downward adjustment will be subject to an overall limit of US$48.5 million.

C. Net Foreign Assets of the RBM

11. **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.

12. **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

13. **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

14. 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.

15. 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.

16. **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 resulting kwacha-denominated value for budget support will be measured as a cumulative flow from the beginning of the 2015/16 fiscal year running to the end of the program period. 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 17. 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–June, 2016
(Billions of Kwacha, cumulative from the beginning of the 2015/16 fiscal year[1])

	Mar-16	Jun-16
Budget support, at the program exchange rate	18.6	18.6
Budget support plus kwacha equivalent of US$ 10 mil, at the program exchange rate	25.6	25.6

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

- **Donor pool accounts for the social sectors** (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. They will be measured as a cumulative flow from the beginning of the 2015/16 fiscal year running to the end of the program period. 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 17. 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–June, 2016
(Billions of Kwacha, cumulative from the beginning of the 2015/16 fiscal year[1])

	Mar-16	Jun-16
Donor inflows, at the program exchange rate	10.7	11.2

[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 will be measured in the foreign currency of payment and converted to kwacha using the program exchange rates. They will be measured as a cumulative flow from the beginning of the 2015/16 fiscal year running to the end of the program period. 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 AfDB 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 17.

Table F. Program Baseline: Projected Debt Service Payments, March–June, 2016
(Billions of Kwacha, cumulative from the beginning of the 2015/16 fiscal year[1])

	Mar-16	Jun-16
Debt service, at the program exchange rate	5.1	7.4

[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 is currently 7.5 percent.

17. **Cumulative adjustment to the NDA program target:** Notwithstanding the adjustments outlined above in paragraph 16, 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.

18. **After applying the adjusters outlined in paragraphs 15 and 16, the ceiling on NDA will be subject to a further adjustment for the level of humanitarian spending.** The ceiling on NDA will be adjusted upward by the amount of government spending above MK13 billion used to purchase maize and other food items specifically to alleviate the current humanitarian crisis. For the purposes of this adjuster, eligible government spending will be defined as: (i) the cost of maize and other foodstuffs purchased and transferred to the World Food Program (WFP) in Malawi for the use in WFP-administered food relief operations; and (ii) financial assets transferred to the WFP in Malawi for use in WFP-administered food relief operations, including cash transfers to relief recipients. This additional upward adjustment will be subject to an overall limit equal to the kwacha equivalent of US$48.5 million. The kwacha equivalent of US$48.5 million will be calculated as US$48.5 million multiplied by the program exchange rate. The Kwacha equivalent of the additional spending will be calculated as the sum of (i) the cost of the humanitarian relief items purchased in kwacha converted to US dollars at the RBM mid rate prevalent on the date of the purchase; plus (ii) the cost of the humanitarian relief items purchased in foreign currency and converted if necessary to US dollars at the market rate prevalent on the date of the purchase.

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

19. **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) the stock of promissory notes issued to cover exchange rate valuation losses of RBM; (ii) the stock of government securities issued in 2015 and 2016 to clear government domestic arrears up to a maximum exclusion of MK157 billion; and (iii) any government net borrowing undertaken to redeem those securities issued in 2014 and 2015 to clear government domestic arrears. 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 and running to the end of the program period, including promissory notes and securities transferred to the RBM from the treasury since the beginning of the fiscal year. 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

20. 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 resulting Kwacha-denominated value for budget support will be measured as a cumulative flow from the beginning of the 2015/16 fiscal year running to the end of the program period. 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. They will be measured as a cumulative flow from the beginning of the 2015/16 fiscal year running to the end of the program period. 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 and education 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 21.

- **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. They will be measured as a cumulative flow from the beginning of the 2015/16 fiscal year running to the end of the program period. 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 AfDB 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 21.

21. **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 (AfDB) relative to the program baseline 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.

22. **After applying the adjusters outlined in paragraph 20, the ceiling on CGDB will be subject to a further adjustment for the level of humanitarian spending.** The ceiling on CGDB will be adjusted upward by the amount of government spending above MK9 billion used to purchase maize and other food items specifically to alleviate the current humanitarian crisis. For the purposes of this adjuster, eligible government spending will be defined as: (i) the cost of maize and other foodstuffs purchased and transferred to the World Food Program (WFP) in Malawi for the use in WFP-administered food relief operations. This additional upward adjustment will be subject to an overall limit equal to the kwacha equivalent of US$48.5 million. The Kwacha equivalent of US$48.5 million will be calculated as US$48.5 million multiplied by the program exchange rate. The kwacha equivalent of US$48.5 million will be calculated as US$48.5 million multiplied by the program exchange rate. The Kwacha equivalent of the additional spending will be calculated as the sum of

(i) the cost of the humanitarian relief items purchased in kwacha converted to US dollars at the RBM mid rate prevalent on the date of the purchase; plus (ii) the cost of the humanitarian relief items purchased in foreign currency and converted if necessary to US dollars at the market rate prevalent on the date of the purchase.

G. Ceiling on External Payment Arrears

23. **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

24. **Definition of concessional debt**. A debt is understood to be concessional if it includes a grant element of at least 35 percent. The grant element is the difference between the nominal value of the loan and its present value, expressed as a percentage of its nominal value. The present value of the debt is calculated on the date on which it is contracted by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is five percent.

25. **Definition of non-concessional external debt:** The definition of debt, for program purposes, is set out in point 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Executive Board Decision No. 15688, as published on the IMF website. For program purposes, 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 26. 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 2015/16 fiscal year.

26. **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, 2015, up to the amount actually used for the above-mentioned purposes; (v) normal import financing; and (vi) 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.

27. The ceiling on non-concessional external debt is US$77.5 million, tied to AFDB water project (US$55 million) and a China project on e-government (US$22.5 million).

QUANTITATIVE INDICATIVE TARGETS

28. **Reserve money of the RBM:** Reserve money of the RBM is defined in paragraph 13 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–June, 2016
(Billions of Kwacha, end-of-period stocks)

	Mar-16	Jun-16
Reserve Money	207	176.4

29. **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 be subject to downward adjusters under the program. Quarterly social spending under this definition is presented in Table 6.

STRUCTURAL BENCHMARKS

30. **Structural benchmarks** are contained in Tables 3 and 4.

31. **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.

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

	Target type [2]	End-June 2015				End-Sept 2015 (IT)				End-Dec 2015			
		Prog.	Adjusted Prog.	Act.	Status	Prog.	Adjusted Prog.	Act.	Status	Prog.	Adjusted Prog.	Act.	Status
I. Monetary targets (millions of kwacha)													
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	87,033	93,063	39,169	Met	73,959	33,594	39,032	Not met	83,792	30,139	-70,410	Met
2. Ceiling on reserve money[3]	IT	243,828	243,828	213,046	Met	248,213	248,213	198,144	Met	260,545	260,545	198,144	Met
II. Fiscal targets (millions of kwacha)													
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	37,030	43,060	94,297	Not met	40,407	32,850	7,329	Met	58,162	51,489	4,269	Met
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	257,430		281,141	Met	54,725		65,132	Met	146,687		140,876	Not met
III. External sector targets (US$ millions, unless otherwise indicated)													
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	487	472	536	Met	531	549	500	Not met	537	522	489	Not met
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0		0	Met	0		0	Met	0		0	Met
7. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0		0	Met	0		0	Met	0		0	Met
8. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0		0	Met	0		0	Met	0		0	Met
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9]	PC				Met				Met				Met
Memorandum items:													
Net foreign assets of the RBM (US$ millions)		390		433		433		396		440		416	
Budget support (US$ millions)		18.07		0		0		26.6		7		26.6	
Budget support (millions of kwacha)		8000		0		0		17,982		3,224		17,982	
Debt service payments to the World Bank andAfDB (US$ millions)		12.12		12		3.90		1.7		7.80		3.0	
Debt service payments to the World Bank and AfDB (millions of kwacha)		4,872		4872		1,568		683		3,136		1206	
Health SWAp receipts (millions of kwacha)		15,668		11,939		2,114		0		14,993		0	
Education SWAp receipts (millions of kwacha)		3,384		2,594		0		0		0		0	
NAC receipts (millions of kwacha)		0		478		164		5,649		332		231	
Program exchange rate (kwacha per US$)		402				402	402	402		402		402	

Source: IMF staff projections.

[1]Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks unless otherwise specified.

[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 2. Malawi: Quantitative Targets, 2016[1]

	Target type [2]	End-June 2016 Prog.	Adjusted Prog.	Act.	Status
I. Monetary targets (millions of kwacha)					
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	-90,331			
2. Ceiling on reserve money[3]	IT	176,413			
II. Fiscal targets (millions of kwacha)					
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	38,000			
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	292,675			
III. External sector targets (US$ millions, unless otherwise indicated)					
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	473			
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0			
7. Ceiling on non-concessional external debt [9,10]	PC	77.5			
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, end of period)		381			
Budget support (US$ millions)[7]		26.60			
Budget support (millions of kwacha)		20,528			
Nominal external concessional borrowing (US$ millions)[11]		150			
Debt service payments to the World Bank and AfDB (US$ millions)[7]		11.45			
Debt service payments to the World Bank and AfDB (millions of kwacha)		8,015			
Health SWAp receipts (millions of kwacha)[7]		14,993			
Education SWAp receipts (millions of kwacha)[7]		0			
NAC receipts (millions of kwacha)[7]		3,850			
Program exchange rate (kwacha per US$)		700			

Source: IMF staff projections.

[1]Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks unless otherwise specified.

[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.

[10]The ceiling comprises US$55 million from the AfDB for a water project and US$22.5 million from China for an e-government project.

[11]Concessional borrowing during the first half of fiscal year 2016/17

Table 3. Structural Benchmarks for the 7th and 8th Reviews, 2015

Measures	Target date	Macro Rationale	Status
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.	Met
Reconcile all government bank accounts MG1 and six operational accounts and ways and means for all FY2014/15 transactions signed by the Accountant General and Secretary of the Treasury.	End-Feb 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Not met
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-Dec 2015	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Not met
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.	Not met
Produce and publish monthly summary bank account control reports.	End-September 2015	To improve transparency and control.	Not met
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.	Not met
Issue a report by an International firm confirming the status of implementation of forensic audit recommendations in the PFM domain.	End-Feb 2016	Foster greater transparency.	Not met
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.	Met
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.	Met
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.	Met
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.	Met
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.	Not Met
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.	Met
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.	Met

Sources: IMF staff and Malawian authorities.

Table 4. Malawi: Prior Actions for the 7th and 8th Reviews and Structural Benchmarks for 2016

Measures	Target date	Macro Rationale	Status
Prior Actions for completion of the seventh and eight reviews			
Reconcile all government bank accounts in MG1 and five operational accounts and ways and means for all FY2015/16 transactions (until end-December 2015). Have the completed reconciliations signed by the Accountant General and the Secretary of the Treasury		To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Pending
Prepare a report on the flow and stock of arrears at end-2015.		To monitor emergence of arrears.	Met
Structual Benchmarks			
Public financial management			
Publish detailed monthly budget execution data by vote for the first nine months of FY2015/16 on the Ministry of Finance's website.	End-June 2016	To foster greater fiscal transparency and monitoring.	
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-June 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	
Reconcile the wages account for the first six months of FY15/16.	End-June 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	
Reconcile all government bank accounts in MG1 and six operational accounts and ways and means for all FY2015/16 transactions (July 1, 2015 through June 30 2016). Have the completed reconciliations signed by the Accountant General, the Auditor General, and the Secretary of the Treasury.	End-August 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	
Auditor General to produce and publish an interim audit report covering July 1, 2015 to December 31, 2015.	End-Sept. 2016	To improve transparency and control.	
Issue a report by an International firm confirming the status of implementation of forensic audit recommendations in the PFM domain including controls over bank reconciliations for MG1 and six operational accounts and ways and means for the first half of FY15/16 transactions.	End-Sept. 2016	Foster greater transparency.	
Financial sector			
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 2016	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.	

Sources: IMF staff and Malawian authorities.

Table 5. Malawi: Cross Rates for Nominal Exchanges Rates and Gold Price for the 2016 Program [1]

Gold bullion LBM US$/troy ounce [2]	1,237.00
SDR to US$ exchange rate	0.710
Euro to US$ exchange rate	0.878
Yen to US$ exchange rate	112.630
Yuan to US$ exchange rate	6.467
Rand to US$ exchange rate	14.732
UK £ to US$ exchange rate	0.694
Kwacha to US$ exchange rate	684
Kwacha to SDR exchange rate	964

Source: IMF (International Financial Statistics).

[1] Rates and prices as of end-March 2016.

[2] LBM connotes London Bullion Market.

Table 6. Malawi: Social Spending: FY2015/16

(Millions of Kwacha)

	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Total Proj.
Category					
Health Expenditure	**20,887**	**17,880**	**22,105**	**22,384**	**83,256**
Wages	12,233	12,383	11,196	11,267	47,080
Other Recurrent	7,904	4,626	9,419	9,627	31,576
Ministry of Health ORT	6,263	3,030	7,900	8,048	25,241
Local Assemblies ORT	1,468	1,424	1,273	1,275	5,440
Subvented Organisations	172	172	246	304	895
Development expenditure	750	870	1,490	1,490	4,600
Education Expenditure	**40,882**	**39,585**	**38,147**	**36,666**	**155,280**
Wages	22,867	22,924	22,416	22,416	90,623
Other Recurrent	17,505	15,991	14,176	12,695	60,367
Ministry of Education ORT	3,810	3,064	3,768	2,285	12,927
Local Assemblies ORT	3,987	3,219	246	246	7,699
Subvented Organisations	9,708	9,708	10,162	10,164	39,742
Development expenditure	510	670	1,555	1,555	4,290
Farm Input Subsidy Program	**-**	**16,500**	**47,429**	**-**	**63,929**
Cement and Iron Sheets Subsidy	**2000**	**1000**	**2000**	**2000**	**7,000**
Gender, Children, Disability and Social Welfare	**969**	**595**	**765**	**758**	**3,086**
Wages	329	337	362	363	1,391
Other Recurrent	560	222	330	333	1,445
Development expenditure	80	36	73	61	250
Local Development Fund	**300**	**90**	**530**	**402**	**1,321**
Poverty and Disaster Management Cost Centre	**95**	**94**	**67**	**68**	**324**
Wages	11	11	11	11	44
Other Recurrent	84	83	56	56	280
Total Social Expenditure	**65,132**	**75,744**	**111,043**	**62,278**	**314,197**

Source: Malawian authorities.

Table 7. 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
Sources of funds for Health and education SWAps accounts 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 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
Data 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
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.

INTERNATIONAL MONETARY FUND

MALAWI

June 3, 2016

SEVENTH AND EIGHTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, AUGMENTATION OF ACCESS, 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 March 31, 2016)

Membership Status

Joined: July 19, 1965; Article VIII

General Resources Account:

	SDR Million	%Quota
Quota	138.80	100.00
Fund holdings of currency (exchange rate)	136.36	98.24
Reserve tranche position	2.44	1.76

SDR Department:

	SDR Million	%Allocation
Net cumulative allocation	66.37	100.00
Holdings	3.65	5.49

Outstanding Purchases and Loans:

	SDR Million	%Quota
ESF Arrangements	20.82	15.00
ECF Arrangements	91.57	65.97

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	07/23/2012	05/22/2016	104.10	65.08
ECF	02/19/2010	07/22/2012	52.05	13.88
ESF	12/03/2008	12/02/2009	52.05	34.70

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

	Forthcoming				
	2016	**2017**	**2018**	**2019**	**2020**
Principal	12.85	15.71	20.41	11.89	13.80
Charges/Interest	0.03	0.06	0.04	0.18	0.14
Total	12.87	15.77	20.45	12.06	13.94

[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:

Commitment of HIPC assistance	Enhanced Framework
Decision point date	Dec 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 Catastrophe Containment and Relief (CCR): Not Applicable.

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Safeguards Assessments:

The 2012 safeguards assessment confirmed that legal reforms were required to address the RBM's lack of operational autonomy. The assessment also reiterated the need to enhance oversight of foreign reserves management, expand disclosures contained in the financial statements and strengthen data compilation procedures. Since then, the RBM has taken steps to ensure that its external audit and financial statements are accordance with international standards. The RBM continues to publish its financial statements while the internal audit function benefitted from implementing the recommendations of an external quality review. Legal amendments were also enacted in 2015 to limit direct advances to the government and strengthen audit and accountability requirements.

The safeguards monitoring visit to the RBM in February 2016 found that all recommendations of the 2012 assessment were implemented, with the exception of the remaining weaknesses in the RBM Act that continue to impede on the bank's autonomy. Steps are underway to address control weaknesses identified in the banking operations. The 2016 monitoring assessment recommended that the RBM's internal audit function assess the operating effectiveness of the enhanced controls through special audits. Also, revision of the investment policy is needed to limit concentration of investments in institutions with a credit rating below investment grade.

Exchange Arrangements:

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

Article IV Consultation:

Malawi is on a 24-month Article IV consultation cycle. The Executive Board concluded the last Article IV consultation with Malawi on December 11, 2015.

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 was published in February, 2005.

Technical Assistance:

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
04/16	STA	NSO	National accounts statistics (follow-up)	Mission
04/16	MCM	RBM	Developing Capacity on the Supervisory Review in the context of Pillar 2 of the Basel Framework	Mission
03/16	MCM	RBM	Developing IT Risk Management Guidelines and Examination Procedures for Banks	Mission
03/16	MCM	RBM	Developing Capacity on Operational and Technology Risk	Mission
02/16	MCM	RBM	Safeguards Assessment	Mission
02/16	MCM	RBM	Internal guideline for foreign exchange intervention	Mission
01/16	FAD	MOF	General tax policy diagnostic including extractive industries	Mission
01/16	FAD	MOF	Introducing New PFM Advisor	Mission
01/16	LEG	MOF	Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)	Mission
11/15	FAD	MOF	Improving the coverage and quality of fiscal reporting	Mission
11/15	MCM	RBM	Money and Repo Market Development	Mission
10/15	STA	NSO	National accounts statistics	Mission
09/15	FAD	MOF	Financial Controls and Disciplines: Enforcing Accountability	Mission
09/15	FAD	MOF	Pension reform proposals	Mission
07/15	FAD	MOF	Improving cash planning and management	Mission
06/15	STA	NSO	Price Statistics	Mission
05/15	FAD	RBM	TADAT Pilot Assessment	Mission
04/15	FAD	MOF	Implementing priority PFM reforms II	Mission
04/15	STA	NSO	National Accounts Statistics	Mission
03/15	LEG	RBM	Helping draft Banking law amendments	Mission
03/15	STA	MOF	Government Finance Statistics	Mission
02/15	STA	NSO	Balance of Payments Statistics	Mission
02/15	STA	NSO	National Accounts Statistics Harmonization	Workshop

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
02/15	MCM	RBM	Advice on the Implementation of ICAAP/SREP supervisory framework.	Mission
01/15	FAD	MOF	Action plan for implementing priority PFM reforms	Mission
11/14	STA	NSO	Assistance with redeveloping data	Mission
11/14	FAD	Ministry of Finance	PFM Action Plan follow-up	Mission
09/14	STA	NSO	Development of direct prices survey for MPIs	Mission
03/14	STA	NSO	Further Assistance on Data Improvement	Mission
03/14	FAD	Ministry of Finance	PFM Reform Program	Mission
11/13	STA	NSO	Balance of Payments Statistics	Mission
09/13	STA	NSO	Price Statistics	Mission
03/13	FAD	Ministry of Finance	Public Financial Management	Mission
02/13	STA	RBM	RBMS' monetary statistics	Mission
02/13	FAD	Ministry of Finance	GFS 2001	Mission
11/12	STA	NSO	Prices Statistics	Mission
10/12	MCM	RBM	Liquidity Management, Monetary Operations and Related Issues	Mission
10/12	FAD	Ministry of Finance/MRA	Revenue Administration	Mission
05/12	STA	NSO	Consumer Price Indices Mission	Mission
04/12	STA	NSO	Balance of Payments Statistics	Mission
04/12	STA	NSO	Provide advice to improve the GDP methodology and assist with improving the data sources and indicators	Mission
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

JOINT MANAGERIAL ACTION PLAN

(May 6, 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. Systematic Country Diagnostic	June, 2016	December, 2016
	2. Country Economic Memorandum	On-going	September, 2016
	3. Disaster Risk Management technical assistance (including a drought Post Disaster Needs Assessment)	On-going	October, 2016
	4. Programmatic Poverty Assessment		June, 2016
	5. Malawi Economic Monitor (two editions)		May and October, 2016
	6. Public Services Improvement Binding Constraints Assessment	May, 2016	June, 2016
	Lending:		
	1. Lilongwe Water Project		May, 2016
	2. Fiscal Resilience Development Policy Operation	June, 2016	March, 2017
	3. Additional Financing to the Nutrition, HIV and AIDS Project	May, 2016	August, 2016
	4. Education Sector Improvement Project		July, 2016
	5. Public Services Reform Project	May, 2016	October, 2016
	6. Shire Valley Irrigation Project	July, 2016	April, 2017
	7. Crisis/Emergency Response Operation(s)	May, 2016	November, 2016
IMF work program in next 12 months	1. Ninth review of ECF-supported program	September, 2016	November, 2016
	2. Tenth review of ECF-supported program	March, 2017	May, 2017
	B. Requests for Work Program Inputs		
Fund request to Bank	1. Updates on WB support to Malawi		Continuous
Bank request to IMF	1. Regular updates and exchange of views on medium-term macroeconomic and fiscal projections including sharing detailed excel tables on Real, Monetary, Fiscal and External Sectors		Continuous
	C. Agreement on Joint Products and Missions		
Joint products in next 12 months	1. Debt Sustainability Analysis (update)	May, 2016	June, 2016

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of May, 2016)

AfDB operations in Malawi date back to 1969. The AfDB Malawi Field Office was opened in 2007. As at 31st March, 2016, the Bank had provided significant and diversified support to Malawi, with cumulative commitments worth UA852.8 million (about US$1.3 billion) to finance 102 operations including 12 studies and 2 lines of credit.

The current Country Strategy Paper (CSP) of the Bank covering 2013–17 is fully aligned to the second Malawi Growth and Development Strategy (MGDS II) covering the period 2011–16 and the Bank's corporate priorities in the Long Term Strategy (LTS, 2013–22). The CSP, currently under implementation, focuses on two pillars: (i) addressing infrastructure bottlenecks to competitiveness and growth; and (ii) supporting actions to expand private sector investment and trade.

The Bank has to date approved projects in the water, agriculture and roads sectors and in Public Financial Management in line with the CSP priorities. To ease challenges posed by Malawi's landlocked position and enhance competitiveness, the Bank has scaled-up support to regional infrastructure to deepen the country's integration with its neighbors. In 2014, the Bank approved the Nacala Road Corridor Phase IV Project (US$64 million). This was followed by the approval in January 2016 of a private sector loan of US$300 million for the Nacala Port and Railway Project, which has a component for Malawi. Other regional infrastructure projects in the pipeline, include the Malawi-Mozambique Power Inter-connector Project and the Songwe River Basin Development Project. The Bank will also promote private investment in infrastructure development, through Public Private Partnerships (PPPs). Currently, the Bank is providing capacity building support to the Malawi Public Private Partnership Commission on PPPs.

The CSP mid-term review was undertaken in 2015 and the strategic priorities have been maintained. The Bank has deepened its support for PFM Reforms and capacity building in coordination with other Development Partners. In September, 2015, the Board approved a grant of US$2.61 million for Phase II of the on-going PFM Institutional Support (ISP). ISP II is providing support for two components: (i) enhancing transparency, control and compliance in the area of procurement and; (ii) strengthening capacity in revenue administration. Implementation of ISP I has commenced.

The Bank has also provided Malawi with quick disbursing budget support. Following Government's 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 an ADF Grant for the Crisis Response Budget Support operation for Malawi in July 2012, in the amount of US$40 million. The Bank designed the Restoration of Fiscal Stability and Social Protection (RFSSP) program whose objective was to contribute to restoring fiscal stability and enhancing public finance management in Malawi, as well as support social protection measures to mitigate the adverse social impact of the devaluation of the Kwacha and the increases in fuel and electricity prices. In order to support this agenda, the RFSSP had two components: (i) strengthened PFM transparency and accountability, and (ii) strengthened social protection system.

In April, 2015, the African Development Fund Board approved a grant of US$30 million for the Protection of Basic Services Programme. This is ring fenced Sector Budget Support, which is designed to protect critical expenditures in health, education and social protection, and improve accountability following suspension of general budget support. The grant was disbursed in one tranche in July, 2015.

Three new operations are programmed for approval in 2016: (i) the Agricultural Sector Budget Support (US$17 million) which is designed to mitigate fiscal pressures related to the drought induced food shortage; (ii) the Agricultural Infrastructure and Youth in Agri-Business Project (US$22 million); (iii) the Lilongwe Water Distribution Network Project (US$56 million); and (iv) the Economic Census and Macro-economic Modelling Project (US$1 million).

Box. AfDB Ongoing Operations

The Bank's current portfolio includes three projects in the agriculture sector: (i) Agriculture Infrastructure Support Project; (ii) Climate Adaptation for Rural Livelihoods; and (iii) Small Holder Irrigation and Value Addition Project. There are currently three projects providing support to the social sector and for economic empowerment: (i) the Local Economic Development project is developing infrastructure in four rural growth centres of Jenda, Malomo, Monkey Bay and Chitekesa; (ii) the Competitiveness and Job Creation Project, which seeks 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 which aims to increase access to technical, entrepreneurship, vocational and training (TEVET) and higher education in Malawi, with particular emphasis on Information and Communication Technology (ICT). In the transport sector the Bank is supporting the Mzuzu-Nkhata Bay Road Rehabilitation Project and the Multinational Nacala Road Corridor Phase IV. Currently, the overall Bank portfolio is rated satisfactory. In the water sector, the Bank is providing support for two projects: the Sustainable Rural Water and Sanitation for Improved Health and Livelihood Project and the Mzimba Integrated Urban Water Project of US$5 million, co-financed with OFID. The two on-going Institutional Support Projects are providing support for the Public Financial Management Reform Programme.

The Bank has also provided support for non-lending activities, including feasibility studies and analytic work to inform the design of new operations and policy dialogue. In 2013, the Bank collaborated with the World Bank and other partners on the Public Expenditure Review. The Bank has in addition provided support for the Expenditure Tracking Study. 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 May 20, 2016
I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Shortcomings remain in the national accounts—mainly due to operational challenges—and government finance statistics.
National Accounts: Since 2010, STA is providing technical assistance (TA) to the National Statistics Office (NSO) on strengthening the quality of national accounts statistics, most recently in April this year. The NSO has revised the national accounts methodology to improve the consistency with the 2008 SNA and develop preliminary quarterly estimates of GDP by economic activity. Further TAs being provided to develop quarterly GDP estimates by expenditure components. Main operational challenges are the NSO's continuing budget constraints, the lack of funds to implement the requisite data collections, and low staffing levels in the national accounts unit.
Price Statistics: An updated and revised consumer price index (CPI) was introduced in January 2013. In addition to new weights and items, the updated CPI reflects improved index calculation methods, the implementation of the internationally recommended Classification of Individual Consumption by Purpose (COICOP), and improved compilation methods. In April 2013, an updated PPI for manufacturing was released, reflecting updated weights. There remains a need to expand the coverage of the PPI to include additional economic activities. The NSO is in process of developing export-import price indexes.
Government Finance Statistics: The accuracy and reliability of the data are affected by source data weaknesses, especially coming from inaccuracies in recording and consolidating the data. Due primarily to differences in coverage and the recording of some subsidies on a funding basis, published data for the budgetary central government include a sizeable statistical discrepancy between above and below the line data reported by the Reserve Bank of Malawi (RBM). While tax revenue data are received in a timely fashion, it is not always possible to reconcile them with deposits in the Malawi Government (MG) Account. This is a result of the way taxes are reported and timing differences between receipt of taxes and cleared funds becoming available for the government. Nontax revenue, including capital revenues collected by line ministries, is not properly accounted for in the fiscal reports prepared by the Ministry of Finance. The authorities have received significant technical assistance from the Fund and other donors to strengthen expenditure monitoring and reporting, accounting, and statistical reporting, but results have lagged. The government has pledged to strengthen fiscal reporting and renewed efforts are being made to establish a work plan, including utilizing donor technical assistance more effectively. The authorities are currently working with East AFRITAC to modify the chart of accounts and output-based structures so that they could more easily be realigned to the national strategy and be more readily understood.

The most recent STA mission in March 2015 proposed and discussed a migration plan and timetable to adopt the GFSM 2001 methodology.
Monetary and Financial Statistics: The RBM recently revamped the other depository corporations (ODCs)' report templates to ensure their consistency with the methodology outlined in the *MFS Manual*. Despite these improvements, progress toward full adoption of the SRF-based monetary statistics is hindered by the quality of the underlying source data for ODCs, where ODCs' balance sheets and their supporting data schedules do not always match.
Financial Sector Surveillance: Malawi does not report Financial Soundness Indicators (FSIs) to STA.
External sector statistics: The external sector statistics are in broad conformity with the fifth edition of the *Balance of Payments Manual (BPM5)*. The NSO has gradually been implementing *BPM6*. However, insufficient resources for collecting survey data and the understaffed balance of payments section continue to hamper further improvements. In the absence of regular source data, some of the components of BOP and IIP data are imputed based on the data from earlier surveys. Procedures for assessing the accuracy of trade data need to be improved. Project aid is currently classified as current transfers rather than in the capital account, and several large in-kind projects are not captured in the balance of payments data properly. Data on foreign direct investment and portfolio flows remains weak. Capacity building programs, including Fund-provided training and technical assistance, seek to overcome the above constraints. In addition, updated BOP and IIP metadata should be made available on the NSO website.

II. Data Standards and Quality	
In FY2016, STA will be conducting an Enhanced General Data Dissemination System (e-GDDS) mission to implement the e-GDDS framework, including a National Summary Data Page in Malawi.	Data ROSC was published on February 17, 2005.

III. Reporting to STA
Government finance data for the Budgetary Central Government in a GFSM 2001 presentation are reported for publication in the Government Finance Statistics Yearbook (GFSY) and International Financial Statistics (IFS). However these data are not disseminated domestically. The RBM reports monetary data on a regular basis, with monthly data disseminated through the *International Financial Statistics (IFS)*. The NSO reports the BOP and IIP data to STA annually in the *BPM6* format.

Malawi: Tables of Common Indicators Required for Surveillance

(As of May 20, 2016)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/2015	03/2016	M	M	M
Reserve/Base Money	12/2015	03/2016	M	M	M
Broad Money	12/2015	03/2016	M	M	M
Central Bank Balance Sheet	12/2015	03/2016	M	M	M
Consolidated Balance Sheet of the Banking System	12/2015	03/2016	M	M	M
Interest Rates[2]	12/2015	03/2016	M	M	M
Consumer Price Index	04/2016	05/2016	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA.	NA			
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/2015	03/2016	M	M	I
Stocks of Central Government and Central Government-Guaranteed Domestic Debt[5]	12/2015	03/2016	M	M	M
External Current Account Balance	12/2015	03/2016	A	A	A
Exports and Imports of Goods and Services	12/2015	03/2016	A	A	A
GDP/GNP	12/2015	03/2016	A	A	A
Gross External Debt	12/2015	03/2016	A	I	I
International Investment Position[6]	2014	03/2016	I	I	I

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

[2] Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

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

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

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

INTERNATIONAL MONETARY FUND

MALAWI

June 3, 2016

SEVENTH AND EIGHTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, AUGMENTATION OF ACCESS, MODIFICATION OF PERFORMANCE CRITERION, AND REPHASING OF DISBURSEMENTS—DEBT SUSTAINABILITY ANALYSIS

Approved By
David Owen and Steven Barnett (IMF) and John Panzer (IDA)

The Debt Sustainability Analysis has been prepared jointly by IMF and International Development Association staff using the debt sustainability framework for low-income countries approved by the Boards of both institutions.

Malawi faces a moderate risk of debt distress based on an assessment of public external debt, with heightened vulnerabilities related to domestic debt.[1] *Malawi's*[2] *debt situation is somewhat better than indicated in the last DSA*[3] *mostly on account of recent rebasing of GDP. Except for the debt service-to-revenue ratio – which displays a marginal and temporary breach in 2016, baseline external debt burden indicators remain below their indicative thresholds, but stress tests show that a weaker debt outcome is possible under the historical scenario. The projected borrowing path and debt policies remain broadly unchanged since the last DSA.*

[1] The DSA was prepared by Pranav Gupta (Economist, IMF) and Richard Record (Senior Economist, World Bank).

[2] Malawi has weak capacity of debt monitoring and the average CPIA score for past three years stands at 3.15.

[3] *IMF Country* Report *No. 15/83, March 2015.*

BACKGROUND

1. **The last Low Income Country Debt Sustainability Analysis (DSA) conducted in March 2015 concluded that Malawi's external public debt faced moderate risk of debt distress.** Malawi's external debt situation has shown a slightly improvement since the last DSA on account of the rebasing of GDP and (to a lesser extent) lower incremental external borrowing in 2015.

2. **Malawi's score under the World Bank's Country Policy and Institutional Assessment (CPIA), which measures the quality of a country's present policy and institutional framework, improved slightly in 2015.** The CPIA assesses how conducive that framework is to fostering poverty reduction, sustainable growth, and the effective use of development assistance. Malawi's score peaked to 3.4 in 2007 before deteriorating to 3.1 in 2013. Thus, the 2015 score of 3.2 represents a modest recovery. Malawi performs better than the average for SSA in the areas of social inclusion and equity (with a score of 3.5, much higher than 3.2 for SSA), and is broadly in line with regional averages for public sector management and institutions (3.1 vs. 3.0 of SSA). Structural policies are also at par with the average of SSA (3.2), while economic management stands below regional average at 3.0 (compared to 3.3 for SSA). Since 2014, Malawi has been subject to the tighter debt thresholds for DSA analysis reflecting a weak policy and institutional framework. The recent small improvement in the CPIA score does not affect debt thresholds for Malawi.

3. **To improve the debt monitoring capacity and strengthen the debt management framework, Malawi has established a debt management committee.** Malawi has recently managed to fully operationalize the Debt Management Committee, whose membership is at senior level. The committee will look at each external borrowing and ascertain its concessionality. It will also ensure that external debt remains sustainable and the right balance of cost and risks is achieved.

4. **Malawi's National Statistical Office recently rebased the country's GDP series by updating the base year from 2007 to 2010, resulting in nominal GDP revised upwards by 29 percent.** The new series is based on an updated set of reference prices and better reflects current economic developments. The rebasing has fundamental implications for a number of key indicators, including a decline in the actual revenue-to-GDP and public debt-to-GDP ratios[4].

Recent Debt Developments

5. **Malawi's public and publicly guaranteed (PPG) external debt stood at about US$1.78 billion (37.0 percent of GDP) in 2015, compared to US$1.45 billion (30.8 percent of GDP) in 2013.** At the end of 2014, the nominal value of PPG external debt stood at US$1.8 billion, which fell marginally to US$1.78 billion in 2015 on account of lower external borrowing by the central government and the recent

[4] Prior to GDP rebasing in 2014, the public and publicly guaranteed external debt to GDP ratio stood at 44.0 percent in 2013, which now is revised down to 30.8 percent in 2013.

exchange rate depreciation[5], which reduced the face value of PTA debt outstanding. The PTA debt restructuring loan[6] was contracted in 2014 in US dollars with the repayment to be done in Kwacha. This implies that as the exchange rate depreciates, the dollar denominated face value of PTA debt declines. Despite the fall in nominal value of debt in 2015, the debt to GDP ratio has increased because of the sharp decline in the GDP deflator caused by the recent depreciation of the exchange rate.

6. **The external debt of Malawi is held mainly by multilateral creditors, with 75 percent of the total in 2015, and the remainder held by bilateral creditors** (Text Table 1). The main provider of loans to Malawi is the International Development Association (IDA) (33 percent), followed by the African Development Fund (ADF) (13 percent) and the IMF (9 percent). China and India are the main holders among bilateral creditors, with China accounting for about 14 percent of total debt. Data on private external debt remains unavailable, but the amounts are not believed to be large.

Text Table 1. Malawi: Composition of Public and Publically Guaranteed External Debt

(Million USD)

	2013		2014		2015	
	Actual	Share	Actual	Share	Actual	Share
Multilaterals	1011.00	69.85	1357.40	75.22	1343.10	75.33
IMF	198.20	13.69	176.00	9.75	162.81	9.13
IDA	416.50	28.78	501.40	27.79	589.90	33.09
ADF	190.90	13.19	226.00	12.52	228.77	12.83
IFAD	75.60	5.22	77.40	4.29	71.80	4.03
other multilateral	129.80	8.97	376.60	20.87	289.83	16.26
		0.00		0.00		0.00
Bilateral	413.60	28.58	432.60	23.97	439.48	24.65
France	10.80	0.75	3.30	0.18	0.00	0.00
Belgium	2.20	0.15	1.90	0.11	1.72	0.10
People's Republic of China	252.40	17.44	244.00	13.52	242.74	13.61
India	106.20	7.34	141.80	7.86	151.74	8.51
others	42.00	2.90	41.60	2.31	43.28	2.43
		0.00		0.00		0.00
Commercial	22.78	1.57	14.49	0.80	0.39	0.02
Total	**1447.38**	**100.00**	**1804.49**	**100.00**	**1782.97**	**100.00**

Sources: Malawian authorities; and IMF staff estimates.

7. **Gross domestic debt increased from MK206.6 billion (13.8 percent of the new rebased GDP) at the end of 2012 to MK538.2 billion (16.8 percent of GDP) at the end of 2015.** As illustrated in Text Table 2, this increase is largely due to:

[5] The Kwacha depreciated by around 36 percent from July 2015 to February 2016.

[6] An equivalent to 4.1 percent of GDP of RBM advances was converted into Treasury notes and sold to a regional non-resident bank (PTA bank) in December 2014–January 2015. The PTA debt restructuring loan was considered as external loan despite repayment to be made in local currency on account of the lender (PTA bank) being a non-resident. At the time of contracting, the government sold to PTA three-year maturity Treasury bills, equivalent to US$250 million. The US dollar value of Treasury notes held by PTA declined following the recent steep depreciation of the Kwacha.

- The rise in government net domestic financing (NDF) during FY13/14 and FY14/15, following the drop in external financing in the wake of the "cashgate" scandal; NDF averaged 3.7 percent of GDP during these two fiscal years and was covered by a mix of issuance of treasury bills and accumulation of ways and means advances from the RBM.

- The issuance of promissory notes in 2013–14 in the amount of MK58 billion (2.3 percent of the 2014 GDP) by the government to recapitalize the central bank following losses that arose from the 2012 devaluation of the exchange rate.

- The securitization of domestic arrears in March 2013 (2.2 percent of GDP) and in 2015 (1 percent of GDP). The 2013 issuance securitized close to MK40 billions of verified old arrears, through promissory notes maturing in 2017, at the T-bill rates plus 200 basis points. The 2015 issuance is related to a stock of domestic arrears uncovered in late 2014 (about MK157 billion). Of that stock, MK31 billion had been verified, audited and paid by zero-coupon promissory notes at end-2015.

- The issuance of a substantial amount of treasury notes (4.8 percent of GDP) with maturity ranging from two to seven years, during the second half of 2015. About one-third of the issued amount was through a conversion of ways and means. The objective of these issuances was to restructure the maturity profile of the local public debt as well as to assist in financing maturing debt and the development budget.

Text Table 2. Composition of Gross Domestic Debt

(Percent of GDP)

	2012	2013	2014	2015
		Actual		
Treasury bills at cost value	9.0	9.1	6.9	6.2
Treasury notes	2.7	1.8	1.3	6.1
Local registered stocks (LRS)	0.2	0.1	0.1	0.0
Ways and means advances from RBM	1.7	5.2	3.0	0.9
Promissory notes for recapitalization of banks	0.1	1.5	2.3	2.0
Promisory notes for clearance of arrears	0.0	2.2	1.4	1.6
Commercial bank advances	0.1	0.0	0.0	0.0
Total	**13.8**	**19.8**	**14.9**	**16.8**

Sources: Malawian authorities and IMF staff estimates.

UNDERLYING DSA ASSUMPTIONS

8. **Weather-related shocks, compounded by macroeconomic instability during 2015 resulted in several areas of underperformance relative to the March 2015 DSA.** First flooding and then drought severely affected the maize crop and weakened growth (by 2.7 percentage points) and contributed to

higher annual inflation (24.9 percent at end-2015). The Kwacha, like most currencies in the region, has experienced a sharp depreciation since end-June. Despite robust tobacco exports, overall exports dropped because of lower agricultural exports and the closure of the uranium mine. The baseline maintains the assumption of a gradual reduction in the external current account deficit beyond 2016 through export diversification and productivity improvement in the exportable sectors. It also assumes a gradual lowering of the reliance on grants and concessional financing over the long-term. End-of-period inflation is programmed to drop to single digits by end-2017. The key macroeconomic assumptions are summarized in Box 1.

9. It is assumed that the current policy mix aimed at restoring macroeconomic stability will be pursued over the medium-term. These policies will consist of tighter fiscal and monetary policies to keep inflation on a declining trend, PFM reforms to improve the quality of spending and mobilization of revenues, and structural reforms to address supply-side bottlenecks and improve factor productivity.

Box 1. Baseline Macroeconomic Assumptions

Real GDP growth is projected to gradually recover from 2.7 percent in 2016 to 5 percent in 2018 and to remain close to 5.5 percent over the longer term, driven by agriculture, improved productivity across sectors and population growth rate.

Inflation (end-of period) is projected to gradually decline from 24.9 percent at end-2015 to 15.8 percent by December 2016 and to reach single digits by 2017 in the absence of other weather-related shocks. The continuation of tight fiscal and monetary policies should help anchor inflation expectations based on the decline in nonfood inflation for five consecutive months.

The exchange rate is projected to remain constant in real terms in medium-long term.

The tax revenue to GDP ratio is expected to increase in FY15/16 and FY16/17 due to higher tax collection in international trade following, the recent sharp depreciation and improved efficiency of tax administration. In long run, we assume that the tax revenue will gradually increase from 16.8 percent of GDP in FY16/17 to 22 percent of GDP in FY35/36, as a result of reforms in tax administration and policy.

External debt will be mainly contracted over the medium term from multilateral creditors on concessional terms, with the remainder being bilateral on less concessional terms. Budget support from multilateral and bilateral donors is assumed to remain subdued for FY 2015/16 and into the medium term.

The current account deficit is projected to increase in 2016 due to higher imports of food supplies to compensate for domestic food shortage, which would be financed by higher off-budget donor support. Going forward from 2017, the current account is projected to remain at a gradual declining path.

New disbursements on external loans. For 2016 and the first half of 2017, new disbursements on external loans are taken from the authorities' fiscal framework, which projects capital spending covered by external loans to reach 3.8 percent of GDP in FY15/16 and 2.9 percent of GDP in FY16/17. It is assumed that external project loans will remain close to 2.7 percent of GDP in subsequent fiscal years.

Net domestic financing. It is assumed that government net domestic financing will be limited to less than 1 percent of GDP in each fiscal year beyond FY16/17, thus contributing marginally to the change in domestic debt.

Text Table 3. Macroeconomic Forecasts and Assumptions (Previous and Current DSA) 1/

Year	Real GDP growth		Primary deficit (percent of GDP) 2/		Change in public debt (percent of GDP)	
	Previous	Current	Previous	Current	Previous	Current
2013	5.2	5.2	1.9	-2.2	14.9	10.4
2014	5.7	5.7	-1.6	-0.3	3.7	-2.6
2015	5.5	3.0	-0.9	-2.0	-15.5	5.8
2016	5.7	2.7	-3.1	-2.5	-3.3	-1.7
2017	6.0	4.5	-2.4	-0.2	-6.2	-5.0
2018	5.9	5.0	-0.9	-0.6	-1.1	-2.4
2019	5.8	5.5	-1.2	-0.3	-1.9	-2.1
2020	5.9	5.5	-0.5	-0.7	-1.9	-1.0
Avg 2021-2034	6.0	5.5	1.0	-1.4	-2.0	-0.2

Sources: Malawian authorities and IMF staff calculations and projections.
1/ Base year for previous DSA was 2013 and is 2015 for the current DSA.
2/On a calendar year basis.

Borrowing Plan

10. **Malawi is expected to contract around US$170 million of concessional loans in FY2015/16 and plans to contract about US$379.5 million in FY2016/17.** Malawi contracted about US$119.5 million in the first half of FY 2015/16 on concessional terms, with a major portion contracted with multilateral donors for infrastructure projects. The rest of the amount is expected to be contracted in the second half of the fiscal year. In FY2016/17, the government expects to borrow US$379.5 million, 80 percent of which would be on concessional basis, whereas the remaining 20 percent would be on a non-concessional basis. The loans would primarily for the health, education and agricultural sectors. The DSA assumes that about 20 percent of new borrowing in 2016–18 would be non-concessional, an assumption which largely accommodates disbursements on two nonconcessional loans. The major portion of the nonconcessional borrowing would be from the African Development Bank with a grant element slightly less than 35 percent. These borrowing plans (Text Table 4.) are consistent with authorities' objective of social development and poverty reduction and with maintaining overall medium- to long-term debt sustainability.

Text Table 4. Authorities' External Borrowing Plan

PPG external debt contracted of guaranteed	**Volume of new debt in USD Million (FY2016/17)**	**Volume of new debt in USD Million (FY2017/18)**
Source of debt financing		
Concessional debt	302	160
Multilateral debt	279	**130**
Bilateral debt	23	30
Non-concessional debt	77.5	20
Total	**379.5**	**180**
Use of debt financing		
Health, Education,Water,Sanitation and Irrigation	187	65
Agriculture, Trade, Industry and Private Sector Development	170	95
ICT (E-government)	22.5	20

Sources: Malawian authorities and IMF staff estimates.

EXTERNAL PUBLIC DEBT SUSTAINABILITY

11. Except for a very modest breach in 2016 in the debt service to revenue ratio, all external debt indicators remain well below their policy-dependent debt-burden thresholds. Debt service is high in 2016 because of large amortization related to debt restructuring operation with PTA, which causes a temporary breach of the threshold, but the ratio falls significantly once the PTA related amortization is completed. Our rating assessment is also supported by the probability approach to the DSA (figure 3), which yields an improved profile for debt dynamics and breaches under the stress tests, providing a clearer case for moderate risk. In 2016 and 2017, the nominal value of PPG external debt is projected to fall further on account of the large amortization repayment related to the PTA loan. Also, recent GDP rebasing lowers the overall debt profile compared to the previous DSA, helping to improve debt dynamics.

Stress Tests

12. Standard tests indicate that a somewhat weaker debt outcome is possible under certain conditions. The strongest impact on the indicators arises under the historical scenario, when the average current account deficit was around 10.1 percent of GDP and low foreign direct investment (around 1.5 percent of GDP), causing the PV of debt to GDP and the PV of debt to exports to breach the thresholds and remain at elevated levels. Since the last DSA, the team has moved to the IMF BPM6 classification. In the past, project and dedicated grants were classified in the current account but are now reclassified in the capital account, leading to significant increase in historical values of the current account deficit[7]. This explains why the breach under the historical scenario is more pronounced compared to the last DSA. However, Malawi is unlikely to run high and protracted current account deficits in medium-long term because (i) prior to 2012, Malawi had a pegged exchange rate regime, with exchange rate highly overvalued, which has now been removed (ii) as the business environment improves, we expect increases in FDI inflows, especially in the energy sector.

PUBLIC DEBT SUSTAINABILITY

13. Gross domestic debt as a percentage of GDP is projected to gradually decline from 18.9 percent of GDP at end-2016 to about 14 percent of GDP at end-2036. These projections assume that (i) the cost value of all maturing T-bills and the face-value of all maturing Treasury notes will be continuously rolled over; (ii) the government net domestic financing will be limited to less than 1 percent of GDP in each fiscal year after 2016[8]; (iii) the issuance of zero coupon promissory notes for the payment of domestic arrears uncovered in late 2014 will be gradually completed by mid-2017, after verification and

[7] Average of current account over last 10 years was around -5.5 percent of GDP, compared to -10.1 percent under the revised classification. For example, under the reclassification, current account for 2011 and 2012 were revised from -5.9 percent and -3.5 percent of GDP to -9.3 and -8.7 percent of GDP respectively.

[8] Domestic financing is expected to increase in 2016 in order to respond to the drought.

audit; and (iv) all maturing promissory and Treasury notes, including those sold to PTA bank, will also be automatically converted into advances from the central Bank and ultimately into marketable securities.

14. The baseline scenario projects a gradual decline in public debt to GDP. The levels and paths for total public debt are in line with the March 2015 DSA, with debt to GDP indicators about 2 percentage points higher than desirable benchmarks, in spite of the substantial decline in this ratio caused by the rebasing of GDP. The breach is caused due to significant increase in domestic debt related to PTA amortization[9]. Standard tests suggest that the debt dynamics would deteriorate relative to the baseline (Figure 2 and Table 3). The strongest impact is under the fixed primary balance scenario, where we assume that the primary deficit would remain constant at the 2016 level (2.5 percent of GDP) for the remainder of projection period. In 2016, the primary deficit is expected to increase on account of additional maize procurement (around 1 percent of GDP) related to drought. However, the deficit is unlikely to remain high beyond 2017.

Policy Implications

15. Malawi continues to face a number of external financing risks that can only be addressed by increased fiscal restraint in order to ensure that growth in the country's debt takes place at a sustainable pace. As such, fiscal tightening is expected to be the policy response to unexpected negative financing shocks (such as delayed or lower donor support, lower tax revenue or growth shocks). Higher than assumed domestic borrowing would bring additional pressures on the exchange rate and on non-food inflation, and crowd out private sector borrowing and investment, while also eroding perceptions of government commitment to policy reforms and maintaining macroeconomic stability.

16. A key challenge will be absorbing the impact of a second year of droughts and food security challenges in fiscal year 2016/17. The authorities are expected to rely primarily on additional grant financing in order to meet household maize consumption needs as a result of the weak harvest.
The authorities will explore additional cuts in domestically financed development expenditure, and in other goods and services in order to meet any gaps in food security needs and to avoid additional unplanned domestic borrowing. Hence government will need to carefully balance the maintenance of stability in key macroeconomic variables, with an effective drought response and the maintenance of core public services that reach the poorest segments of the population. In this scenario, there is a strong case to be made for confronting the political challenges of reducing expenditure in political sensitive areas, including subsidy programs (such as on fertilizer), and exercising restraint over the management and growth of public sector compensation.

Authorities' Views

17. The Malawian authorities concurred with the analysis and conclusion of this DSA.
They agreed with staff that a prudent external borrowing and a consolidated fiscal position limiting

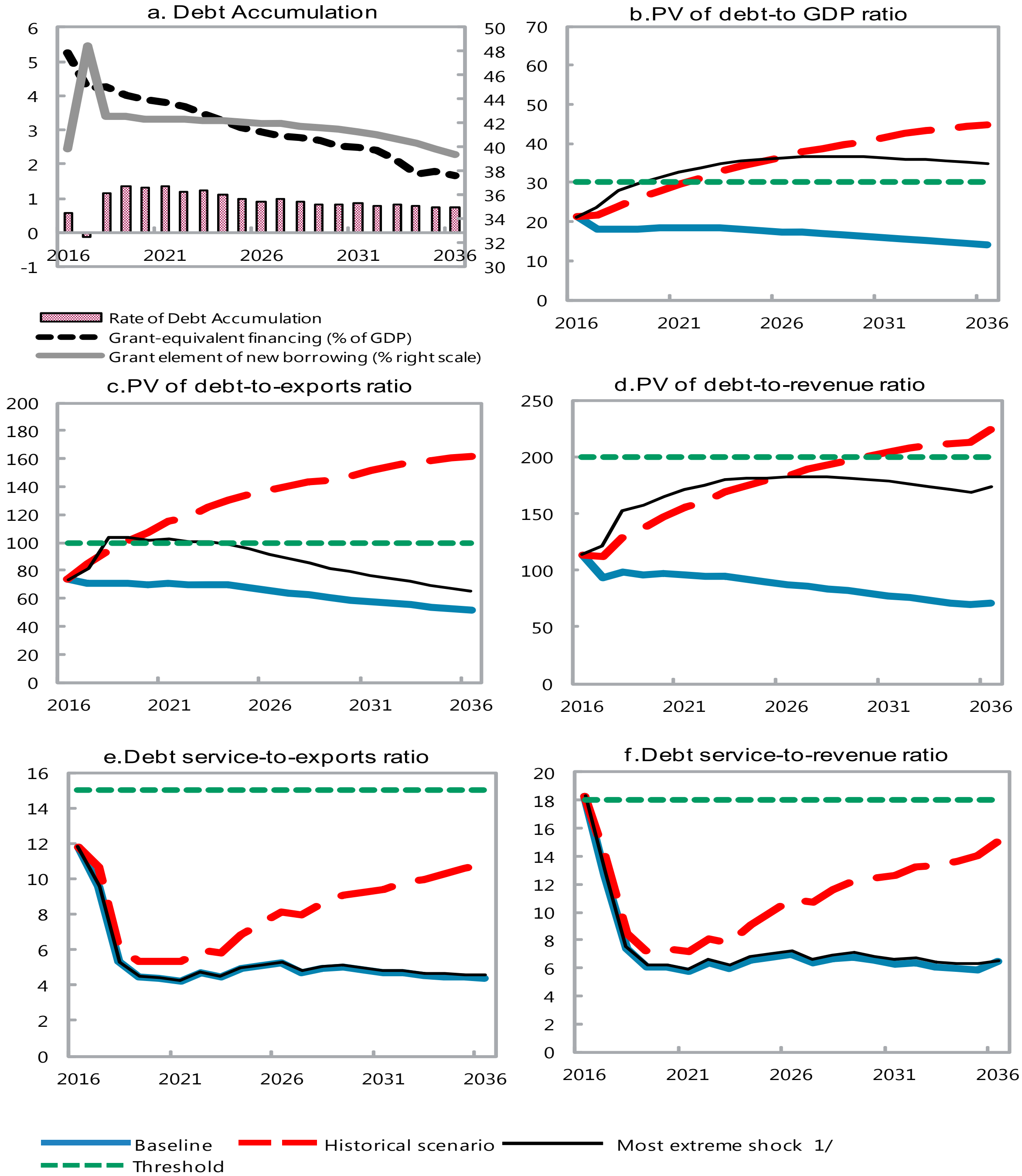
[9] Domestic debt is projected to increase from 16.8 percent in 2015 to 18.9 percent in 2016. We assume that as the PTA debt is amortized, the debt is rolled over from foreign to domestic.

domestic financing needs will be key to maintaining total debt sustainability. Achieving this objective will require strengthening debt management and relying on concessional debt to the extent possible.

CONCLUSIONS

18. Malawi remains at moderate risk of debt distress, based on an assessment of external public debt, but heightened overall risks remain, reflecting vulnerabilities to domestic debt and external conditions. Risks of export-related and weather shocks remain, and have materialized since the last DSA. Malawi suffers from vulnerabilities related to a dependency on a short and predominantly rain-fed agricultural season in order to meet food security needs and an increased frequency of climate-induced weather shocks. These vulnerabilities can be mitigated by long-term investments in infrastructure and diversification of the economy. Absorption of such weather shocks while maintaining macroeconomic stability and debt sustainability will require careful macroeconomic management and difficult policy choices. Similarly, risks of negative financing shocks in the form of delayed donor support, or lower- than -expected revenue also remain, given Malawi's high aid dependency. This calls for further efforts to broaden the tax base and strengthen public financial management.

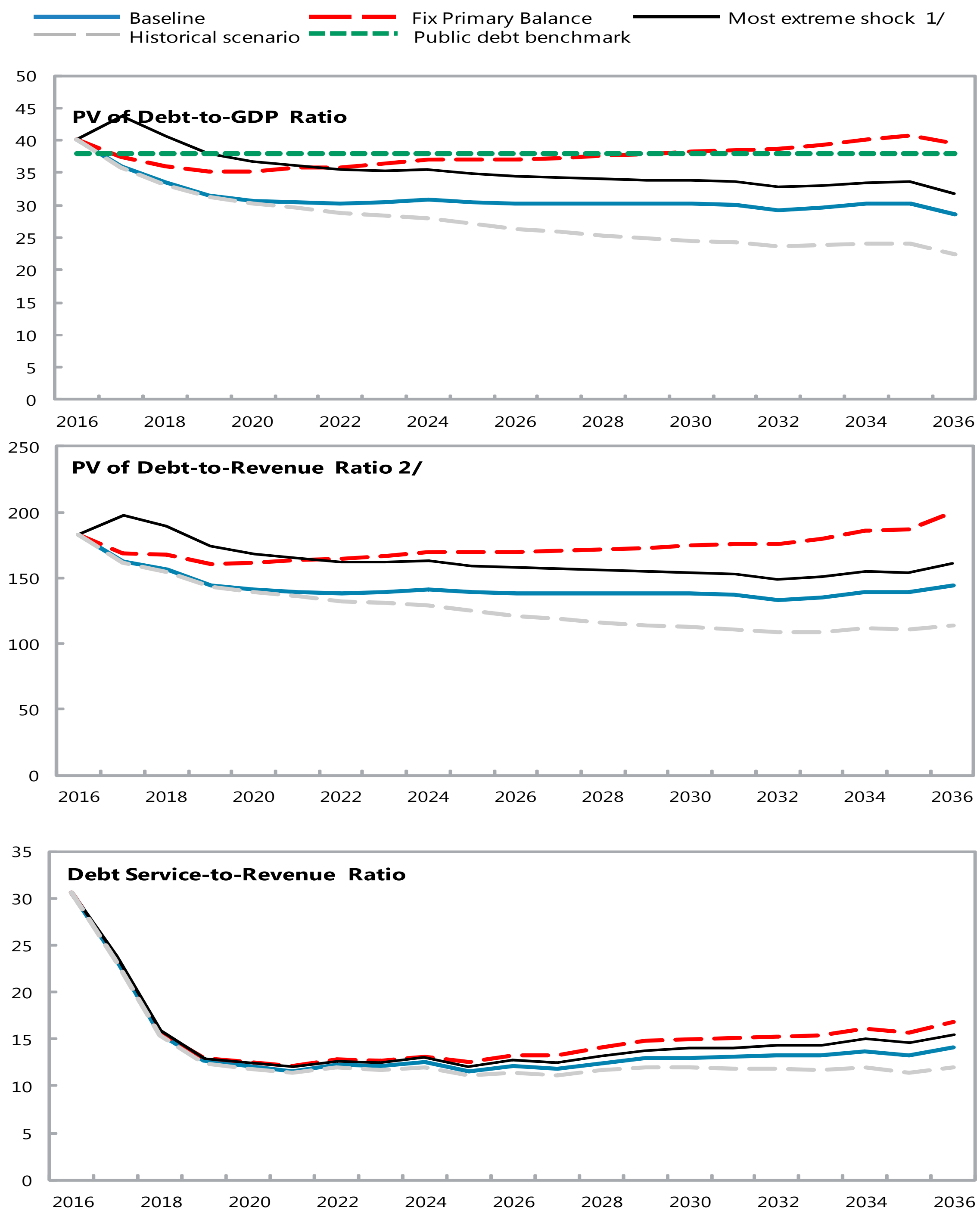
Figure 1. Malawi: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2016–2036 1/



Sources: Malawian authorities and IMF staff estimates and projections.

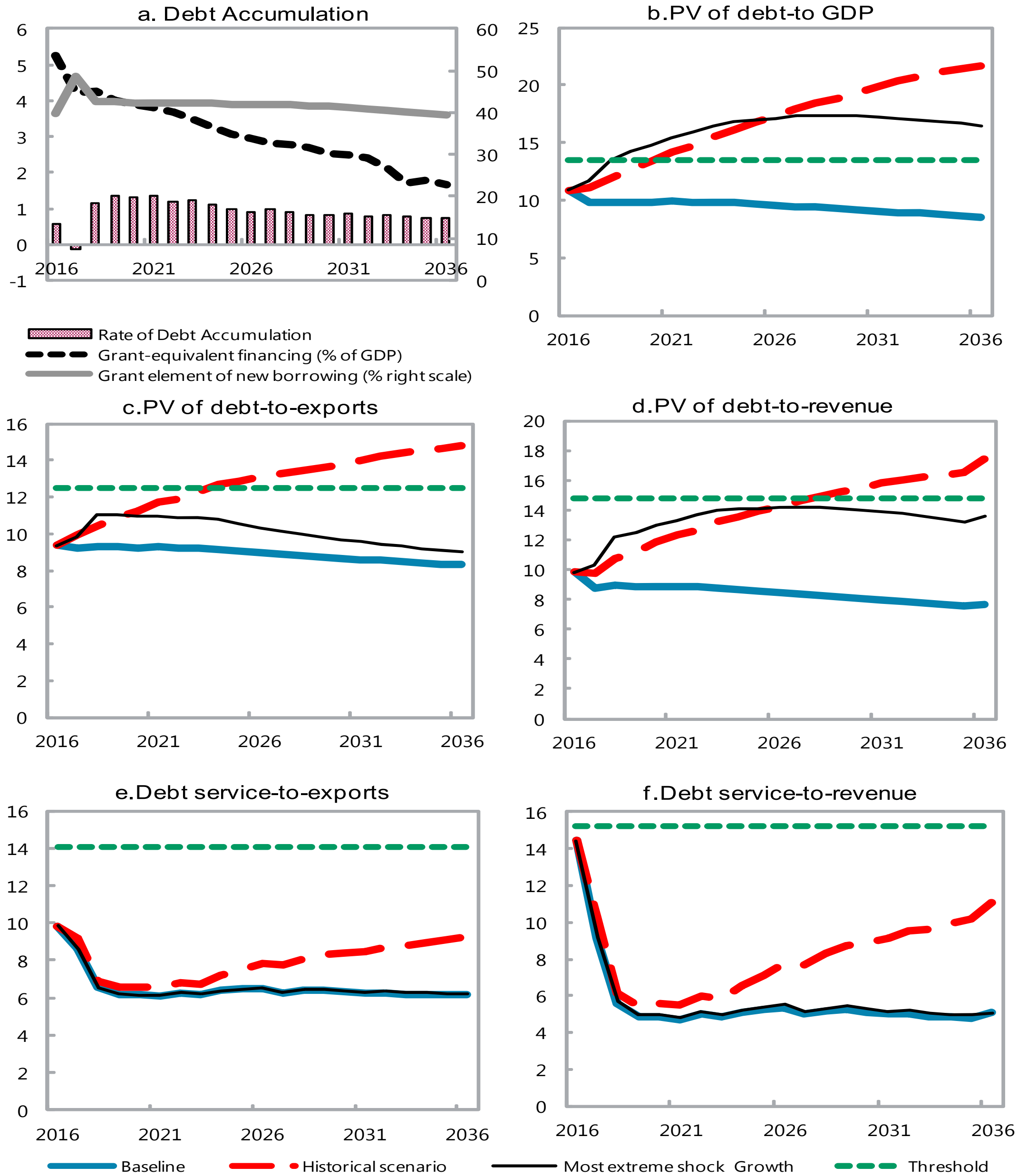
1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to a GDP deflator shock; in c. to a Exports shock; in d. to a GDP deflator shock; in e. to a Growth shock and in figure f. to a Growth shock.

Figure 2. Malawi: Indicators of Public Debt under Alternative Scenarios, 2016–2036 1/



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 2026.
2/ Revenues are defined inclusive of grants.

Figure 3. Malawi: Probability of Debt Distress of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2016–2036 1/



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 2026. In figure b. it corresponds to a GDP deflator shock; in c. to a Exports shock; in d. to a GDP deflator shock; in e. to a Growth shock and in figure f. to a Growth shock.

Table 1. Malawi: External Debt Sustainability Framework, Baseline Scenario, 2013–2036

(Percent of GDP, unless otherwise indicated)[9]

	Actual			Historical[6/] Average	Standard[6/] Deviation	Projections									
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-2021 Average	2026	2036	2022-2036 Average
External debt (nominal) 1/	**34.8**	**36.7**	**40.4**			**37.0**	**32.3**	**32.1**	**32.1**	**31.8**	**31.6**		**29.2**	**23.5**	
of which: public and publicly guaranteed (PPG)	30.8	33.1	37.0			33.2	29.1	29.2	29.3	29.2	29.2		27.5	22.6	
Change in external debt	4.5	1.9	3.7			-3.4	-4.7	-0.2	-0.1	-0.2	-0.2		-0.6	-0.5	
Identified net debt-creating flows	10.1	4.2	4.4			9.9	4.6	4.0	3.6	3.8	4.0		3.8	3.6	
Non-interest current account deficit	**8.5**	**8.4**	**8.0**	**10.1**	**3.2**	**13.3**	**8.4**	**7.7**	**7.4**	**7.5**	**7.6**		**7.3**	**6.4**	7.0
Deficit in balance of goods and services	12.1	10.9	10.4			16.2	10.7	9.8	9.3	9.4	9.6		9.1	8.2	
Exports	30.5	28.7	25.2			29.0	25.6	25.4	25.6	26.1	25.9		26.6	27.7	
Imports	42.6	39.6	35.6			45.1	36.3	35.2	35.0	35.5	35.5		35.7	35.9	
Net current transfers (negative = inflow)	-6.4	-5.1	-4.9	-5.6	1.4	-5.3	-4.5	-4.2	-4.1	-4.0	-4.0		-3.7	-3.2	-3.6
of which: official	-1.3	0.0	-0.4			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	2.7	2.5	2.5			2.4	2.2	2.1	2.1	2.1	2.0		1.9	1.4	
Net FDI (negative = inflow)	**-1.7**	**-0.8**	**-1.8**	**-1.6**	**1.0**	**-3.0**	**-2.8**	**-2.4**	**-2.4**	**-2.4**	**-2.4**		**-2.3**	**-1.9**	-2.2
Endogenous debt dynamics 2/	**3.3**	**-3.4**	**-1.8**			**-0.4**	**-1.1**	**-1.2**	**-1.4**	**-1.4**	**-1.3**		**-1.2**	**-1.0**	
Contribution from nominal interest rate	0.2	0.2	0.2			0.8	0.3	0.3	0.3	0.3	0.3		0.3	0.3	
Contribution from real GDP growth	-1.7	-1.8	-1.0			-1.2	-1.4	-1.5	-1.7	-1.7	-1.6		-1.5	-1.2	
Contribution from price and exchange rate changes	4.8	-1.8	-1.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-5.6**	**-2.3**	**-0.7**			**-4.6**	**-4.0**	**0.7**	**1.1**	**0.8**	**0.6**		**-0.1**	**-0.6**	
of which: exceptional financing	-1.8	-3.7	-2.3			-3.2	-2.8	-2.8	-2.8	-2.7	-2.7		-2.5	-1.9	
PV of external debt 4/	...	...	28.0			25.0	21.2	21.1	21.0	20.9	20.8		19.2	15.1	
In percent of exports	...	...	110.9			86.4	83.0	82.7	82.0	80.2	80.5		71.9	54.6	
PV of PPG external debt	**...**	**...**	**24.5**			**21.2**	**18.0**	**18.1**	**18.2**	**18.3**	**18.4**		**17.4**	**14.2**	
In percent of exports	**...**	**...**	**97.3**			**73.2**	**70.5**	**71.0**	**71.1**	**70.1**	**71.0**		**65.4**	**51.4**	
In percent of government revenues	**...**	**...**	**133.4**			**113.8**	**93.2**	**98.3**	**96.3**	**96.5**	**96.1**		**87.5**	**71.3**	
Debt service-to-exports ratio (in percent)	**1.7**	**4.3**	**5.2**			**11.8**	**9.6**	**5.3**	**4.5**	**4.4**	**4.2**		**5.2**	**4.4**	
PPG debt service-to-exports ratio (in percent)	**1.7**	**4.3**	**5.2**			**11.8**	**9.6**	**5.3**	**4.5**	**4.4**	**4.2**		**5.2**	**4.4**	
PPG debt service-to-revenue ratio (in percent)	**2.8**	**6.6**	**7.2**			**18.3**	**12.7**	**7.4**	**6.1**	**6.0**	**5.7**		**7.0**	**6.5**	
Total gross financing need (Billions of U.S. dollars)	0.4	0.6	0.5			0.8	0.6	0.5	0.5	0.5	0.6		0.8	1.5	
Non-interest current account deficit that stabilizes debt ratio	4.0	6.5	4.3			16.7	13.1	7.9	7.5	7.7	7.8		7.9	6.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.2	5.7	2.9	5.8	2.4	2.7	4.5	5.0	5.5	5.5	5.5	4.8	5.5	5.5	5.5
GDP deflator in US dollar terms (change in percent)	-13.7	5.5	2.8	0.7	11.8	-12.4	13.3	2.6	0.8	1.2	1.3	1.1	1.5	1.8	1.6
Effective interest rate (percent) 5/	0.7	0.5	0.5	0.6	0.1	1.8	1.1	0.9	1.0	1.0	1.0	1.1	1.1	1.2	1.1
Growth of exports of G&S (US dollar terms, in percent)	16.6	4.8	-7.0	12.2	16.4	3.4	4.6	7.1	7.2	8.5	6.2	6.2	8.3	7.6	7.7
Growth of imports of G&S (US dollar terms, in percent)	1.5	3.7	-4.8	6.9	15.8	14.0	-4.9	4.7	5.6	8.3	6.8	5.8	7.4	7.2	7.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	39.8	48.5	42.5	42.5	42.4	42.3	43.0	42.0	39.3	41.3
Government revenues (excluding grants, in percent of GDP)	18.2	18.6	18.4			18.6	19.3	18.4	18.9	18.9	19.1		19.9	20.0	20.1
Aid flows (in Billions of US dollars) 7/	0.4	0.4	0.3			0.3	0.3	0.3	0.3	0.3	0.4		0.4	0.5	
of which: Grants	0.3	0.2	0.2			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.2	
of which: Concessional loans	0.1	0.2	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.2	0.3	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.2	4.2	4.3	4.0	3.9	3.8		2.9	1.7	2.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			63.6	74.6	72.9	71.9	71.8	71.2		67.3	57.1	65.2
Memorandum items:															
Nominal GDP (Billions of US dollars)	5.4	6.1	6.4			5.8	6.8	7.4	7.8	8.4	8.9		12.6	25.5	
Nominal dollar GDP growth	-9.2	11.5	5.9			-10.0	18.4	7.8	6.4	6.8	6.9	6.0	7.1	7.4	7.2
PV of PPG external debt (in Billions of US dollars)			1.2			1.2	1.2	1.3	1.4	1.5	1.6		2.2	3.6	
(PVt-PVt-1)/GDPt-1 (in percent)						0.6	-0.1	1.1	1.3	1.3	1.4	0.9	0.9	0.7	0.9
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)	...	...	24.5			21.2	18.0	18.1	18.2	18.3	18.4		17.4	14.2	
PV of PPG external debt (in percent of exports + remittances)	...	...	97.3			73.2	70.5	71.0	71.1	70.1	71.0		65.4	51.4	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	5.2			11.8	9.6	5.3	4.5	4.4	4.2		5.2	4.4	

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).

9/ Residual for 2016 and 2017 is high on account of projected financing gap resulting from spending for humanitarian relief.

Table 2. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–2036

(Percent)

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of debt-to GDP ratio								
Baseline	21	18	18	18	18	18	17	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	21	22	24	26	28	30	37	45
A2. New public sector loans on less favorable terms in 2016-2036 2/	21	19	19	20	21	21	23	24
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	21	18	18	18	19	19	18	15
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	21	19	22	22	22	22	20	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	21	23	28	30	31	33	36	35
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	21	19	20	20	20	20	19	15
B5. Combination of B1-B4 using one-half standard deviation shocks	21	24	28	29	30	31	32	28
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	21	25	26	27	28	30	32	30
PV of debt-to-exports ratio								
Baseline	73	70	71	71	70	71	65	51
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	73	85	94	101	107	115	137	162
A2. New public sector loans on less favorable terms in 2016-2036 2/	73	72	75	78	79	83	87	85
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	73	69	69	70	69	71	66	53
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	73	81	104	103	102	103	91	65
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	73	72	75	79	81	86	92	85
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	73	75	79	79	78	79	71	52
B5. Combination of B1-B4 using one-half standard deviation shocks	73	77	89	92	93	96	96	81
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	73	73	75	78	80	84	88	80
PV of debt-to-revenue ratio								
Baseline	114	93	98	96	96	96	88	71
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	114	112	130	137	147	155	183	224
A2. New public sector loans on less favorable terms in 2016-2036 2/	114	96	103	105	109	112	117	118
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	114	93	98	97	98	98	91	76
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	114	99	118	115	115	114	100	74
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	114	121	153	157	165	170	182	174
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	114	100	109	107	107	106	95	73
B5. Combination of B1-B4 using one-half standard deviation shocks	114	122	154	155	160	163	161	140
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	114	131	142	144	150	154	161	150

Table 2. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–2036 (Concluded)

(Percent)

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
Debt service-to-exports ratio								
Baseline	12	10	5	4	4	4	5	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	12	11	6	5	5	5	8	11
A2. New public sector loans on less favorable terms in 2016-2036 2/	12	10	5	5	5	5	5	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	12	10	5	4	4	4	5	5
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	12	10	7	6	6	6	8	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	12	10	5	5	5	4	6	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	12	10	5	5	5	4	6	5
B5. Combination of B1-B4 using one-half standard deviation shocks	12	10	6	5	5	5	7	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	12	10	5	5	5	4	6	6
Debt service-to-revenue ratio								
Baseline	18	13	7	6	6	6	7	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	18	14	8	7	7	7	11	15
A2. New public sector loans on less favorable terms in 2016-2036 2/	18	13	7	6	7	6	7	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	18	13	8	6	6	6	7	6
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	18	13	8	7	6	6	8	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	18	16	11	9	9	9	12	13
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	18	13	8	6	6	6	8	6
B5. Combination of B1-B4 using one-half standard deviation shocks	18	15	10	8	8	8	12	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	18	17	10	8	9	8	11	12
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	39	39	39	39	39	39	39	39

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 assuming 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.

Table 3. Malawi: Public Sector Debt Sustainability Framework, Baseline Scenario, 2013–2036

(Percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	2022-36 Average
Public sector debt 1/	50.6	48.0	53.8			52.1	47.1	44.7	42.5	41.6	41.3		40.3	36.9	
of which: foreign-currency denominated	30.8	33.1	37.0			33.2	29.1	29.2	29.3	29.2	29.2		27.5	22.6	
Change in public sector debt	10.4	-2.6	5.8			-1.7	-5.0	-2.4	-2.1	-1.0	-0.3		-0.3	-2.0	
Identified debt-creating flows	4.2	-3.9	6.4			-2.9	-4.3	-0.9	-1.5	-1.0	-0.5		0.0	-0.5	
Primary deficit	2.2	0.3	2.0	0.6	2.2	2.5	0.2	0.6	0.3	0.7	1.1	0.9	1.6	0.8	1.3
Revenue and grants	23.9	21.4	20.9			21.9	22.2	21.5	21.8	21.7	21.8		21.8	19.7	
of which: grants	5.7	2.8	2.5			3.3	2.9	3.1	2.9	2.8	2.7		1.9	0.9	
Primary (noninterest) expenditure	26.1	21.7	22.9			24.4	22.4	22.1	22.1	22.4	22.9		23.5	20.5	
Automatic debt dynamics	-0.9	-4.2	4.4			-5.1	-4.5	-1.6	-1.8	-1.7	-1.6		-1.6	-1.3	
Contribution from interest rate/growth differential	-1.6	-2.1	-1.3			-0.3	-1.6	-1.9	-2.1	-1.8	-1.7		-1.7	-1.3	
of which: contribution from average real interest rate	0.4	0.7	0.1			1.1	0.6	0.4	0.2	0.4	0.4		0.4	0.7	
of which: contribution from real GDP growth	-2.0	-2.7	-1.4			-1.4	-2.2	-2.2	-2.3	-2.2	-2.2		-2.1	-2.0	
Contribution from real exchange rate depreciation	0.7	-2.2	5.7			-4.7	-2.9	0.3	0.3	0.1	0.1		...	...	
Other identified debt-creating flows	2.9	0.0	0.0			-0.3	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			-0.3	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)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	2.9	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	6.2	1.3	-0.6			1.2	-0.7	-1.5	-0.6	0.0	0.2		-0.3	-1.5	
Other Sustainability Indicators															
PV of public sector debt	...	...	41.3			40.1	36.0	33.6	31.5	30.7	30.5		30.2	28.5	
of which: foreign-currency denominated	...	...	24.5			21.2	18.0	18.1	18.2	18.3	18.4		17.4	14.2	
of which: external	...	...	24.5			21.2	18.0	18.1	18.2	18.3	18.4		17.4	14.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	6.0	5.7	6.2			9.1	5.5	4.0	3.0	3.3	3.6		4.3	3.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	198.0			183.2	162.2	156.3	144.5	141.2	139.7		138.6	144.6	
PV of public sector debt-to-revenue ratio (in percent)	...	...	224.7			215.2	186.2	182.6	166.4	161.9	159.4		151.9	151.2	
of which: external 3/	...	...	133.4			113.8	93.2	98.3	96.3	96.5	96.1		87.5	75.6	
Debt service-to-revenue and grants ratio (in percent) 4/	16.1	25.1	19.2			30.6	23.7	15.6	12.6	12.1	11.6		12.1	14.0	
Debt service-to-revenue ratio (in percent) 4/	21.1	28.9	21.7			35.9	27.2	18.2	14.5	13.8	13.2		13.2	14.7	
Primary deficit that stabilizes the debt-to-GDP ratio	-8.2	3.0	-3.8			4.1	5.2	3.1	2.4	1.7	1.4		1.9	2.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.2	5.7	2.9	5.8	2.4	2.7	4.5	5.0	5.5	5.5	5.5	4.8	5.5	5.5	5.5
Average nominal interest rate on forex debt (in percent)	1.7	1.3	1.2	1.5	0.3	4.0	2.5	2.1	2.1	2.2	2.2	2.5	2.4	2.5	2.4
Average real interest rate on domestic debt (in percent)	2.6	4.1	-0.1	1.5	4.4	0.8	2.0	2.3	2.0	2.7	3.2	2.2	2.4	3.9	4.1
Real exchange rate depreciation (in percent, + indicates depreciation)	2.9	-7.5	17.7	6.3	25.4	-12.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	27.3	20.9	21.1	15.7	7.0	18.3	13.1	8.3	7.5	7.2	6.9	10.2	5.7	4.9	5.5
Growth of real primary spending (deflated by GDP deflator, in percent)	9.3	-12.0	8.5	0.6	5.8	9.3	-3.9	3.7	5.3	7.2	7.7	4.9	6.4	-5.0	4.8
Grant element of new external borrowing (in percent)	...	...	...	...	...	39.8	48.5	42.5	42.5	42.4	42.3	43.0	42.0	39.3	...

Sources: Malawian authorities and IMF staff estimates and projections.

1/ Data cover central government and are on a gross debt basis.

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 4. Malawi: Sensitivity Analysis for Key Indicators of Public Debt 2016–2036

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of Debt-to-GDP Ratio								
Baseline	40	36	34	32	31	30	30	28
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	40	36	33	31	30	30	26	22
A2. Primary balance is unchanged from 2016	40	37	36	35	35	36	37	40
A3. Permanently lower GDP growth 1/	40	36	34	32	32	32	35	42
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	40	37	35	33	32	33	34	34
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	40	38	36	34	33	33	32	30
B3. Combination of B1-B2 using one half standard deviation shocks	40	37	35	33	32	32	32	30
B4. One-time 30 percent real depreciation in 2017	40	44	41	38	37	36	34	32
B5. 10 percent of GDP increase in other debt-creating flows in 2017	40	42	39	37	36	36	35	31
PV of Debt-to-Revenue Ratio 2/								
Baseline	183	162	156	145	141	140	139	145
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	183	162	155	144	140	137	121	114
A2. Primary balance is unchanged from 2016	183	168	167	161	162	164	170	201
A3. Permanently lower GDP growth 1/	183	163	158	148	146	147	159	213
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	183	164	162	151	149	149	154	171
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	183	169	169	157	153	151	148	151
B3. Combination of B1-B2 using one half standard deviation shocks	183	166	164	152	148	147	146	151
B4. One-time 30 percent real depreciation in 2017	183	197	189	174	169	165	158	161
B5. 10 percent of GDP increase in other debt-creating flows in 2017	183	189	184	171	167	164	159	158
Debt Service-to-Revenue Ratio 2/								
Baseline	31	24	16	13	12	12	12	14
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	31	23	15	12	12	11	11	12
A2. Primary balance is unchanged from 2016	31	24	16	13	12	12	13	17
A3. Permanently lower GDP growth 1/	31	24	16	13	12	12	13	18
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	31	24	16	13	12	12	13	16
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	31	24	16	13	12	12	13	15
B3. Combination of B1-B2 using one half standard deviation shocks	31	24	16	13	12	12	13	15
B4. One-time 30 percent real depreciation in 2017	31	27	19	16	15	15	16	19
B5. 10 percent of GDP increase in other debt-creating flows in 2017	31	24	16	14	13	12	14	15

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.

Statement by the Staff Representative on Malawi
June 20, 2016

This statement provides information that has become available since the issuance of the staff report. The new information does not alter the thrust of the staff appraisal.

Two prior actions were met in the manner contemplated in the staff report. One of the two prior actions (reporting on arrears) was met before circulating the staff report to the Board, and the other related to bank reconciliations was met on June 9, 2016.

Statement by Mr. Mkwezalamba, Alternate Executive Director and Mr. Sitima-wina, Senior Advisor to the Executive Director on Malawi
June 20, 2016

Introduction

1. We thank staff for the constructive dialogue with the Malawian authorities during the program review mission. The authorities appreciate the candid advice from the Fund as they pursue their national development objectives of poverty reduction through sustainable economic growth and infrastructure development as articulated in the second Malawi Growth and Development Strategy (MGDS II). Our authorities broadly concur with the staff assessment and conclusions.

2. The Malawi economy has been hit heavily by two consecutive weather related shocks of heavy floods coupled with dry spells in 2015, followed by the El Niño-induced drought in 2016. These shocks have, overall, led to a decline in output particularly in the agricultural sector leading to food insecurity of almost half of the population. In turn, the shocks adversely affected policy implementation which also constrained meeting some Extended Credit Facility (ECF) performance criteria.

3. This notwithstanding, the authorities remain committed to the objectives of the original ECF arrangement, namely, attaining strong inclusive growth, single digit inflation, and an increase of foreign reserves. Their commitment is manifested through the quick correction of slippages that led to the delay in completion of the seventh review. More importantly, the prior actions agreed for completion of the seventh and eighth reviews in the fiscal area have been fully implemented. Against this background, our authorities solicit Executive Directors' support for completion of the seventh and eighth 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

4. The authorities have made remarkable progress in meeting the ECF performance targets despite the weather-related shocks that negatively impacted on economic activity with an adverse effect on domestic revenue mobilization. This rendered budget execution and implementation of the program under the ECF challenging. Nonetheless, the authorities remain committed to a successful implementation of the program and have taken corrective measures to address the slippages that were encountered. In addition, they have regained momentum in implementing the related structural benchmarks.

5. Our authorities, therefore, request waivers for nonobservance of two periodic performance criteria (PC). First, the PC on net domestic borrowing missed at end-June 2015 related to the seventh review on which strong remedial actions have since been taken. Second, the PC on net international reserves missed at end-December 2015 related to the eighth review on which further tightening of the monetary policy stance has been taken. In addition, they request for an extension of the program to end-December 2016 to allow a re-phasing of

disbursements and facilitate a ninth review that should enable achievement of the original objectives of the program under ECF.

Recent Economic Developments and Macroeconomic Outlook

6. Following the unusual combination of heavy floods followed by droughts, GDP growth is estimated to have declined to 3 percent in 2015 from 5.7 percent in 2014, and is projected to drop further to 2.7 percent in 2016 reflecting weather- related uncertainties. Agricultural output dropped, especially the maize harvest which shrunk by about 30 percent. Consequently, an estimated 2.8 million persons in 25 of the 28 districts in the country were rendered food insecure.

7. In 2016, the El Niño-induced drought has further exacerbated the situation with an additional decline in maize harvest of 12 percent. About half of the population is now estimated to be food insecure in the 2016-17 consumption year. In view of this, the authorities declared a state of a national disaster in April 2016 and requested humanitarian assistance from donors. In addition, the authorities request an augmentation of access under the ECF (25 percent of quota or SDR 34.7 million) to respond to the drought.

8. In December 2015, inflation reached 24.9 percent, driven by rising food prices and depreciation of the kwacha. Since then, it has been on a downward trend and reached 20.9 percent in April 2016. It is expected that single digit inflation will be attained by end-December 2017. In light of weaker aggregate demand on imports and the decline in international oil prices, the current account deficit is projected to have declined from 8.5 percent of GDP in 2014 to 8.2 percent in 2015.

9. In the medium term, overall GDP growth is expected to pick up to about 5.5 percent. The main drivers of this growth will include increased public investment in infrastructure, private investments following an enhanced business environment and normalization of agricultural production. The current account deficit is projected to remain below 9 percent. While the medium-term outlook is characterized by uncertainties due to the impact of the two consecutive droughts, the authorities remain committed to strengthening the macroeconomic environment and sustaining growth on its upward trajectory. Consistent with this outlook, the authorities' short-term priorities will focus on enhancing macroeconomic stability through largely tight fiscal and monetary policies consistent with disinflation, reinforcing PFM systems, and preserving the stability of the financial sector.

Fiscal Policy and Public Financial Management

10. In spite of the challenging fiscal environment, the authorities are pursuing fiscal consolidation through enhanced domestic revenue mobilization, reforming the fertilizer subsidy scheme, and strengthening commitment controls to prevent the reemergence of domestic payment arrears. In this connection, the authorities with technical assistance from the IMF and GIZ are carrying out a comprehensive review of the tax system aimed at creating a simple, efficient, transparent and fair system through broadening the tax base, rationalizing the taxation of international investments and integrating tax policy with the national development strategy. In addition, the review aims at modernizing and stabilizing the tax legislation and eliminating obsolete and contradictory provisions. The underlying principle is to shift away from the heavy reliance on taxes on factors of production to those on consumption. Thus, the draft 2016-2017 budget currently under consideration in parliament proposes rationalization of the value added

tax (VAT) by introducing a standard VAT on products that were either zero-rated or exempt. On the expenditure side, the coverage of the Farm Inputs Subsidy Program (FISP) will be scaled down from 1,500,000 beneficiaries to 900,000 beneficiaries, and steps to further strengthen payroll management are underway.

11. Considerable progress is also being made in public finance management reforms. Among other measures, government bank accounts at the Reserve Bank of Malawi (RBM) have been rationalized and all main accounts have been incorporated into IFMIS, facilitating bank reconciliations and providing a safeguard against fraud. To further enhance fiscal transparency, the authorities have commenced publishing monthly budget execution reports. The commitment control system has also been strengthened. All Ministries, Departments, and Agencies (MDAs) are now required to provide five detailed fiscal reports before receiving their regular monthly funding. In addition, cash management was strengthened by closing a large number of dormant accounts and by the institution of regular meetings of the cash management committee.

12. In the period ahead, the authorities are committed to ensure that total public debt remains sustainable. In this regard, they will further strengthen the debt management framework and aim to identify and address risks associated with rapid debt accumulation.

Monetary and Exchange Rate Policies

13. The RBM has demonstrated strong commitment to stabilizing monetary conditions and bolstering the external reserves position using policy instruments at its disposal. They will continue to maintain tight monetary policy to reduce inflation with the aim of attaining an end-of-period inflation rate of 16 percent by December 2016, and maintaining a minimum of 3 months of import cover in foreign exchange reserves. With respect to the monetary policy architecture, the RBM has improved communication with stakeholders and the general public to raise policy credibility, increase the efficiency of policy transmission, and better anchor inflation expectations. Coupled with greater fiscal discipline and improvements in the PFM systems, our authorities anticipate that the current policy framework is sufficient to keep inflation on a downward trajectory.

14. Further, the authorities aim to maintain positive short-term real money market interest rates through open market operations. The positive rates should in turn increase demand for holding the local currency (kwacha) and eventually help to mitigate the seasonal depreciation pressures that typically appear in the lean season when foreign currency inflows are low. In this regard, the ongoing IMF technical assistance aimed at improving open market operations and liquidity forecasting will go a long way to reinforce the authorities' objectives. Underpinning these policies will be a continued adherence to the flexible exchange rate regime and maintenance of the automatic fuel pricing mechanism.

Financial Sector Policies

15. The resilience of the banking system has further strengthened in the last two years following the measures undertaken by the authorities, including migration to Basel II standards and amendments to the RBM Act. In addition, the authorities adopted a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action against distressed banks. They have also improved prudential norms in the areas of asset classification and provisioning. The new asset classification directive is based on the estimated recoverable

amount method (ERAM) which imposes higher and graduated provisioning rates, and is expected to strengthen banking sector resilience and improve the ability to deal with adverse developments. In the period ahead, the authorities will continue to safeguard financial sector stability by strengthening the supervision and resolution capacity.

16. Finally, the authorities are aware that credit risk stemming from high exposure to large borrowers poses a significant threat to the banking system. As noted earlier, they have intensified monitoring and supervision and stand ready to take additional steps to ensure banking sector stability.

Conclusion

17. The authorities reiterate their commitment to enhancing macroeconomic stability, reducing poverty and attaining a sustainable inclusive growth. In this connection, they will implement an appropriate policy mix that places inflation on a downward trajectory and, continue with far-reaching structural reforms, including further strengthen public financial management. The authorities value Fund support in pursuing their broad development agenda enshrined in the MGDS. In this regard, they count on Executive Directors' support in completion of the seventh and eighth reviews; support of requests for waivers for non-observance of performance criteria, extension of the arrangement to December 2016, augmentation of access of 25 percent of quota, modification of performance criterion and re-phasing of disbursements.