INTERNATIONAL MONETARY FUND

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REPUBLIC OF MADAGASCAR

July 2014

REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY; STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF MADAGASCAR

In the context of the request for disbursement under the Rapid Credit Facility, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 18, 2014, following discussions that ended on May 6, 2014, with the officials of Madagascar on economic developments and policies underpinning the IMF arrangement under the Rapid Credit Facility. Based on information available at the time of these discussions, the staff report was completed on June 3, 2014.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for the Republic of Madagascar.

The following documents have been or will be separately released.

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

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

June 3, 2014

REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY

EXECUTIVE SUMMARY

Economic background and outlook. The Malagasy authorities managed to avert a macroeconomic crisis during a difficult period of political transition and economic uncertainty since 2009. However, these disruptions have constrained growth and fiscal revenue, leading to a sharp compression of public investment and social outlays, with serious social consequences. In addition to accumulating domestic payment arrears, budgetary subsidies for fuel, and energy more generally, have become costly and have been crowding out the room for other priority fiscal spending. About 90 percent of the population now lives below US$2 a day (adjusted for purchasing-power parity), making poverty a critical issue for Madagascar. Supported by large mining projects that are reaching commercial output, recovering rice production, and a less uncertain political environment, growth is projected to increase to 3 percent in 2014. However, the economy remains vulnerable with large balance of payments needs that could get in the way of a robust economic recovery if not addressed promptly.

Key challenges. The government's immediate objective for 2014 is to start to raise social and infrastructure spending back to more normal levels and create a solid foundation for faster and more inclusive growth and for poverty reduction. There are large balance of payments and fiscal gaps that need to be filled in order not to jeopardize an economic recovery. Key measures to be undertaken in 2014 include:

- Improve tax and customs revenue collections.
- Increase funding of priority public investment programs and social spending.
- Stop the accumulation of new domestic arrears and clear existing arrears in a phased manner.
- Address the issue of fuel price subsidies over time, while identifying mechanisms for supporting vulnerable groups.

Against this background, the authorities are requesting a disbursement under the Rapid Credit Facility (RCF). They also see the RCF as a stepping stone for a possible future arrangement addressing Madagascar's medium-term challenges and as a positive signal to development partners.

Staff supports the authorities' request for a disbursement under the RCF.

Approved By
David Robinson and Chris Lane

A staff team consisting of Mr. Tsibouris (head), Ms. Carvalho and Viseth, Mr. Engstrom (all AFR), Ms. Muthoora (FAD), and Mr. Pienkowski (SPR) visited Antananarivo during April 23-May 6. The mission met with His Excellency President Hery Rajaonarimampianina, Minister of Finance and Budget Jean Razafindravonona, Minister of Economy and Planning Herilanto Raveloharison, and Acting Governor of the Central Bank of Madagascar Vonimanitra Razafimbelo, as well as representatives of the private sector, civil society, and development partners. Mr. Ismael (OED) participated in the discussions.

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APPENDIX

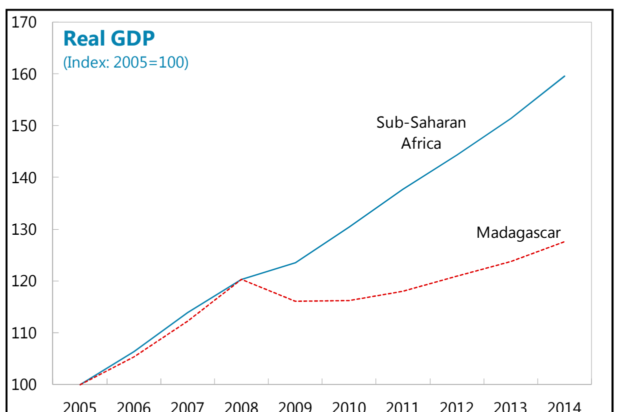
BACKGROUND AND CONTEXT

1. **Elections in December 2013 brought an end to a five year period of political uncertainty, with the new government receiving widespread recognition by the international community.** In March 2009, President Ravalomana fled Madagascar following a period of civil unrest, and a Transition Authority was established to govern the country. Following protracted negotiations among the political parties on a "roadmap" towards elections, presidential and parliamentary elections were held in December 2013 and President Rajaonarimampianina was inaugurated in late-January 2014, after winning 53.5 percent of the votes. MAPAR (the party supporting the outgoing President of the Transition Authority) won 49 of the 151 seats in the new National Assembly, while MR (the party of the President exiled in 2009) secured 20 seats. Remaining seats are divided among 29 smaller parties and 25 independents. The Fund normalized its relations with Madagascar on March 12, 2014.

2. **In support of policies outlined below, the Malagasy authorities are requesting a disbursement under the Rapid Credit Facility (RCF)** (25 percent of quota, in the equivalent of SDR 30.55 million). Madagascar is experiencing an urgent balance of payments need, caused by the disruption of production and exports associated with the recent crisis. The import cover of foreign exchange reserves is now at a 15–year low. These challenges are compounded by severe fiscal pressures, resulting in significant domestic budgetary arrears. If not addressed, these imbalances would result in severe economic disruptions. In addition to Fund support through the RCF, a catalytic effect on bilateral and multilateral financial assistance is envisaged.

ECONOMIC DEVELOPMENTS: 2009–13

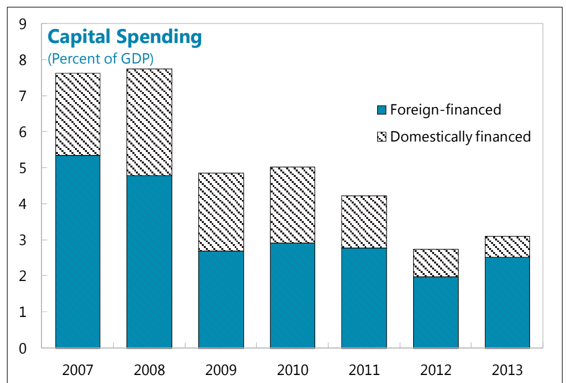
3. **The economic situation deteriorated significantly during the transition period (2009–13).** After several years of reasonably strong economic growth, output contracted in 2009 and remained weak over several years, given a high level of political and economic uncertainty that impacted investment decisions. Had it not been for two large world-class mining projects (being developed pre-transition) that came on stream in 2012, the economic situation would have been much starker, as many other sectors have shown real declines. Over this period, Madagascar also experienced dwindling financial support from development partners, the loss of preferential market access (with debilitating effects for the textile industry), and continued natural disasters (including a locust infestation in 2013).



Source: Malagasy authorities.

4. Social indicators have deteriorated sharply, with most of the Millennium Development Goals (MDGs) now off-track. Madagascar is one of the poorest countries in the world, with about 90 percent of people living below US$2 (PPP) per day. World Bank studies indicate that there have been significant declines in health care and school enrollment. Many of the MDGs had tracked favorably through 2008, but recent surveys indicate a deterioration in several indicators and insufficient progress in many others, with an overwhelming majority of the indicators now being far off-track in terms of reaching the 2015 goals (Table 10). Furthermore, there has been an outbreak of the bubonic plague in five of the island's 112 districts, due in large part to the inability of these communities to provide adequate sanitation services.[1]

5. The authorities averted a macroeconomic crisis, but fiscal spending has been squeezed for several years and budgetary arrears have accumulated. The overall fiscal deficit on a commitment basis worsened from 2.0 percent of GDP in 2008 to an estimated 5.1 percent of GDP in 2013. Tax revenues fell back to historically low levels (just below 10 percent of GDP) since 2009,[2] mainly due to increasing reliance on the informal economy, an apparent increase in corruption, and a deterioration in tax and customs administration. Reforms in public financial management have also faced headwinds. With donor budget support cut off since 2009 (which, in previous years, had financed 40–50 percent of the budget), expenditure cuts have been sharp, targeting public investment and social spending, but it proved impossible to avoid arrears accumulation with the stock estimated at about 3¾ percent of GDP at end–2013, including overdue VAT refunds—there is no evidence of an accumulation of external arrears. The price of fuel has been effectively fixed since 2010, resulting in a budgetary subsidy (now with arrears to suppliers) of about 1½ percent of GDP annually. There was also an increase in statutory spending on public wages during the period, mainly due to real increases across the pay scale. Public debt stood at 34.2 percent of GDP at end–2013.



Source: Malagasy authorities.

6. Inflation was generally maintained at single digits with relatively stable monetary conditions. Large foreign asset inflows, linked to mining FDI, kept broad money growth in the double digits through 2011. As capital inflows eased, broad money growth slowed and became increasingly driven by domestic lending. Credit to the private sector broadly grew in line with nominal GDP until 2012 and then accelerated in 2013 mainly due to overdrafts, including those related to imports of petroleum products. While the banking sector remained relatively liquid and profitable during the past five years, capital outflows in the period leading up to the elections

[1] There have been only five outbreaks of bubonic plague worldwide over the past 20 years.

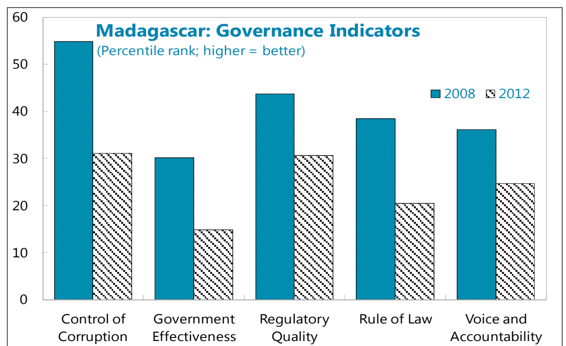
[2] The tax ratio, estimated at 9.3 percent of GDP for 2013, is among the lowest in the sub-Saharan Africa region and below the average for low-income countries.

late-2013 reduced liquidity and resulted in upward pressure on interest rates. During this period, the government was financed in part through a credit line at the central bank. Private sector borrowing has slowed in 2014. Measured year-on-year, credit growth declined from 16 percent at end-December 2013 to 13 percent at end-March 2014.

7. **Balance of payments developments have been influenced by the mining projects' cycle**. FDI inflows related to the mining projects brought foreign exchange reserves to a peak of 3.7 months import cover at end-2011. Foreign exchange reserves started to decrease in 2012, as the central bank temporarily sold foreign exchange at preferential rates to fuel importers. The currency started to weaken in the second half of 2013 and, to ease its depreciation, the Central Bank became a net seller of foreign exchange in the fourth quarter of 2013, with international reserves decreasing to 2.2 months import cover at end-2013. Notwithstanding large purchases of foreign exchange in January 2014, the Central Bank was a net seller also during the first quarter of 2014 and remained so through mid-May 2014. The ariary depreciated about 4 percent against both the US dollar and the euro between end-December 2013 and late-May 2014.

8. **Madagascar's real effective exchange rate appreciated slightly over 2009–13.** While the nominal effective exchange rate depreciated by about 19 percent during 2008–13, inflation differentials resulted in a real appreciation of about 5 percent.

9. **Governance standards have slipped.** This is confirmed by available indicators and civil society has raised concerns about unaccounted exports of precious metals, fuel consumption at the public utility company JIRAMA at odds with expected electricity generation, and petty corruption. At the same time, budgetary resources allocated to the government's functions of budgetary control, evaluation, audit, and sanctions have been constrained.



Source: World Bank; Worldwide Governance Indicators.

POLICIES FOR 2014

10. **Madagascar has urgent balance of payments and budgetary needs that, if not addressed, would result in further economic disruption.** Starting to rebuild foreign exchange reserves will help boost confidence not only in the currency but in an economy that has been buffeted by uncertainty over several years. There is also an urgent need to ease some of the compression in public infrastructure and social spending, while avoiding a further build-up of budgetary arrears and working towards a resolution of the existing stock.

11. **The new government is committed to tackling these objectives in 2014**. They have given priority to promoting macroeconomic and financial stability, so as to provide a favorable environment in support of inclusive economic growth and poverty reduction. Key measures aim to: (i) improve tax and customs revenue collections; (ii) increase funding of priority public investment

programs and social spending; (iii) stop the accumulation of new domestic arrears and clear existing arrears in a phased manner; and (iv) address the issue of fuel prices subsidies over time, while identifying efficient mechanisms for supporting vulnerable groups. A supplementary budget, in line with these priorities and taking into account additional tax revenue and budget support, is planned to be submitted to the National Assembly in July 2014. The RCF disbursement would be in support of the authorities' policy framework for the remainder of 2014 and would give the new government some time to formulate its medium-term strategy to address the country's development challenges.

12. Growth is projected to increase to 3 percent in 2014, supported by large mining projects that are now reaching commercial production, recovering rice production, and a more stable investment environment. The current account deficit should narrow, now that the large mining projects are near completion and food imports are declining. The gradual removal of fuel price subsidies is projected to temporarily increase end-year inflation to 8.5 percent.

A. Fiscal Policy and Reforms

13. The key challenge for fiscal policy in 2014 is to ease spending compression and develop a strategy to clear budgetary arrears against the backdrop of the available resource envelope.[3] An increase in public spending in line with the expenditure needs and obligations of the government by about 2.7 percent of GDP relative to the 2014 budget law is envisaged. Coupled with a preliminary estimate for the stock of arrears of about 3.8 percent of GDP at end–2013, this would imply a financing gap of about 6.5 percent of GDP (Text Table 1).

Text Table 1. Madagascar: Financing Gap in 2014

	Percent of GDP
Additional spending in 2014	2.7
Domestically-financed capital expenditure	0.9
Compensation	0.0
Goods and services	0.4
Transfers	0.5
Fuel subsidies	0.8
Budgetary arrears at end-2013	3.8
VAT refund	1.8
Fuel subsidies	0.4
Other (public utility)	0.6
Special treasury bonds	0.5
Central bank[1]	0.5

Sources: Malagasy authorities and IMF staff estimates and projections.
[1] Net of MGA 10 billion repayment envisaged in the 2014 budget law.

[3] Budgetary arrears identified to date include due and unpaid obligations of the central government on VAT refunds, compensation to petroleum importers, the public utility company, and the central bank (on account of the fuel subsidy policy) as well as repayment of special Treasury obligations. In addition, extra-budgetary arrears on spending undertaken by line ministries outside of the expenditure chain may have accumulated.

14. The resulting fiscal gap in 2014 would be financed by a combination of several measures. These include (i) measures to shore up tax and customs revenue; (ii) close engagement with development partners to ensure that all available budget support materializes; (iii) short-term expenditure reforms to generate cost-savings; (iv) a phased clearance of budgetary arrears over several years; and (v) some additional domestic financing (including through a capitalization of debt owed to the central bank), consistent with macroeconomic stability (Text Table 2).

Text Table 2. Madagascar: Measures to Close the Financing Gap in 2014

	Percent of GDP
Domestic revenue mobilization[1]	1.0
Budget support (grants and loans)	1.6
Cost-savings on expenditure	0.3
Transfers to public utility company	0.2
Fuel subsidy reform	0.2
Deferred arrears clearance	2.0
Additional domestic financing	1.4
Net credit from the banking sector[2]	0.7
Net credit from the non-banks[3]	0.6
Total	6.5

Sources: Malagasy authorities and IMF staff estimates and projections.
1. Because of differences in the accounting of VAT repayments, numbers on domestic revenue mobilization are not directly comparable with data reported in Table 4.
2. Includes an amount of MGA 113 billion in respect of capitalization of debt owed to the Central Bank.
3. Includes the issuance of Treasury instruments for MGA 126 billion for the amortization of special treasury bonds.

15. The authorities plan to submit a supplementary budget to the National Assembly in July 2014 (MEFP ¶12 and ¶15) to reflect the increased spending appropriations and incorporate related measures to close the fiscal gap. The supplementary budget targets an overall deficit of 2.1 percent of GDP (on a commitments basis), with tax revenues amounting to 10.9 percent of GDP, an improvement of about 1½ percentage points relative to 2013. Current spending is projected at 10.8 percent of GDP, while capital spending would nearly double (relative to 2013) to 6.1 percent of GDP. Domestic bank financing is projected at 1.3 percent of GDP.

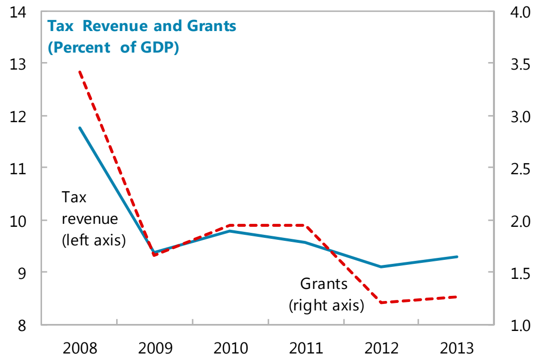
16. On the revenue side, the authorities' focus will be on tightening controls in order to bolster tax revenue collections in both the customs and the tax administrations. In particular, efforts will be devoted to increased physical inspection and verification to ensure compliance with sales/tax invoicing requirements and to avoid fraudulent declarations and undervaluation for imports (MEFP ¶ 12). Fund technical assistance to both the tax and customs administrations is envisaged. The authorities will keep careful watch on tax revenue performance, including through the establishment of quarterly floors on cumulative tax revenue collections. Should tax revenues fall short of expectations, the pace of the scale-up of capital outlays would be adjusted.

17. In terms of expenditures, the government's strategy will be to increase priority spending on infrastructure and the social sectors, while creating fiscal space, primarily through subsidy reform and efficiency gains at the public utility company that would reduce the need for transfers (MEFP ¶13, ¶17, ¶18, and ¶23).

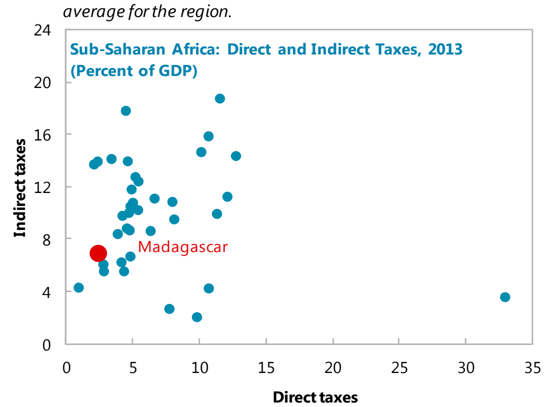
- The authorities envisage a phased removal of the current fuel subsidy regime, by increasing fuel (diesel, gasoline, and kerosene) prices at the pump in successive quarterly steps starting in July 2014. Once fuel prices have reached a level where subsidies are no longer necessary, the minimum fuel price will be determined by an automatic-pricing mechanism that ensures full

Figure 1. Madagascar: Fiscal Sector Developments

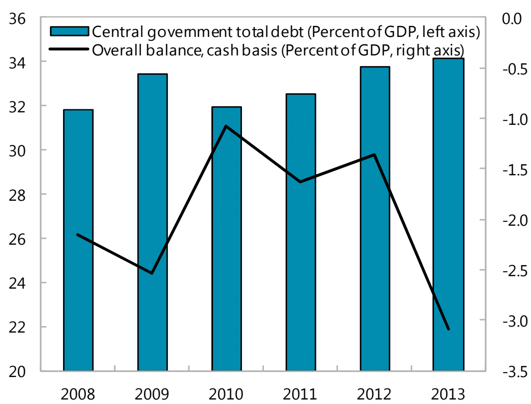
The crisis has taken a toll on budgetary resources.



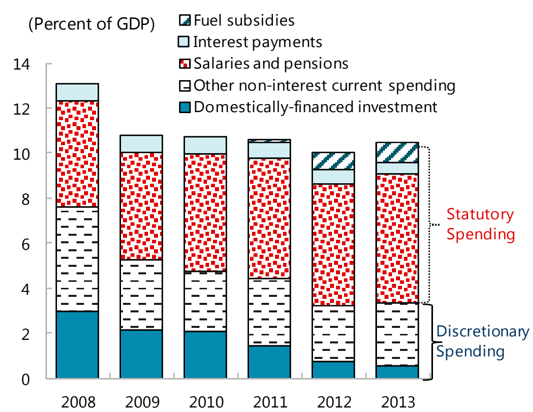
Tax revenues have reached historic lows and are below the average for the region.



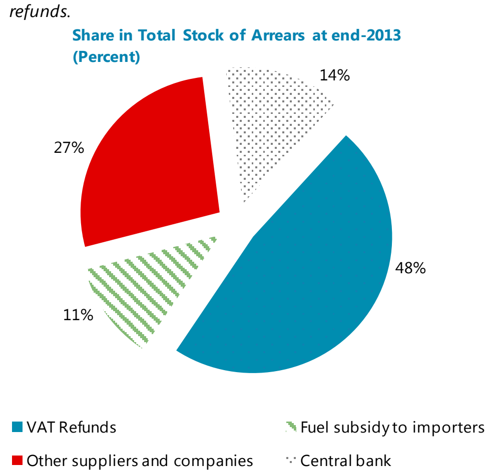
The authorities managed to avoid a fiscal crisis and increases in the debt level have been moderate...



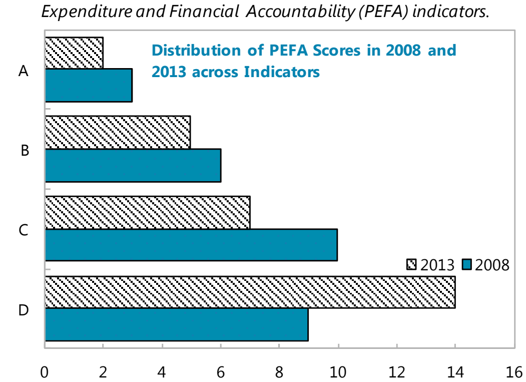
...but this came at the cost of lower spending...



...and accumulation of domestic arrears, particularly on VAT refunds.



Madagascar has also fallen behind on several Public Expenditure and Financial Accountability (PEFA) indicators.



The chart is based on self-assessment on 28 indicators. The scores correspond to the following: A-Process mastered; B-Process mastered room for improvements; C-Process existing, non-compliant results or not adequately mastered; D-Failing Process implementation on inexistent process.

Sources: Malagasy authorities; and IMF staff estimates.

cost recovery.[4] Presently, a small, relatively well-off proportion of the population is receiving most of the economic benefits from this subsidy. Importantly, however, the transition to market-determined prices will be supported by well-targeted measures to mitigate the impact on the most vulnerable, aimed at urban transport and an intensification of existing targeted social safety net mechanisms (cash-for-work and conditional transfers). An extensive information campaign is also planned (MEFP ¶17 and ¶18).

- The authorities aim to realize cost-savings in the operations of the public utility company, JIRAMA, to reduce the need for transfers from the central government budget. In the short-term reforms aimed at enhancing the accountability of the fuel input supply chain as well as to reduce electricity theft will be implemented (MEFP ¶ 23). Reforms aimed at strengthening the governance of JIRAMA are also envisaged. The authorities also intend to develop a medium-term rehabilitation strategy for JIRAMA, with the assistance of development partners.

- Public investments will more than double from their 2013 level, with significant boosts in both foreign-financed outlays, as well as domestically-financed ones (including counterpart funds). In doing so, attention will be given to the quality of investment and the economy's absorption capacity. The government has also committed to protecting spending in the areas of education, health, and nutrition and has specified indicative floors for these outlays for the remainder of 2014 (MEFP ¶13).

18. In addition, given the resource constraints, the government has developed a multi-year strategy to repay budgetary arrears (MEFP ¶14). Further work will be undertaken to refine the current estimate of the stock of domestic arrears at end–2013 (3.8 percent of GDP). Bilateral negotiations have been initiated with creditors to discuss repayment terms and modalities. To date, an agreement has been reached on the settlement of the debt owed to the central bank and two other public entities through recapitalization and issuance of special Treasury instruments. A partial clearance of arrears is envisaged in 2014 through an appropriation of resources in the supplementary budget.

B. Monetary and Exchange Rate Policies

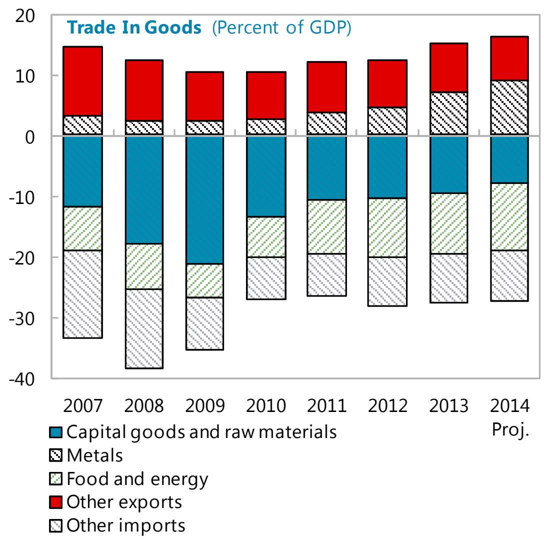
19. Monetary policy will aim at supporting economic growth while maintaining single-digit inflation. In pursuing reserve money targeting with a flexible exchange rate, the authorities envisage that reserve and broad money (M2) will grow by 11 percent and 13 percent, respectively, in 2014. The authorities are committed to letting the exchange rate be determined by market conditions, while at the same time steadily rebuilding their reserve cover. Foreign exchange reserves are projected to reach at least SDR 529 million or the equivalent of 2.3 months of import cover by end–2014.

[4] Diesel fuel prices would need to increase about 18 percent to reach international prices; for gasoline and kerosene, the increases are of the order of 5–10 percent. This move to international prices is projected to increase inflation temporarily by 2 percentage points, according to a World Bank study.

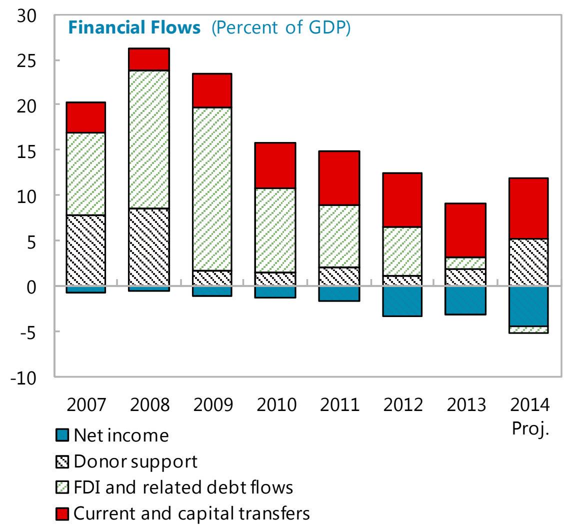
20. There are no signs of immediate problems in the banking sector with non-performing loans (NPLs) remaining at a relatively moderate level. The banking license of a small, non-systemic bank, which had been operating with steady losses for several years, was recently withdrawn and the liquidation process is expected to be completed within six months. The banking sector is small—eleven banks, all of which are foreign owned. Against this background, the central bank is aiming to establish a framework for financial market development. Fund TA in the form of a diagnostic needs assessment in the monetary area is envisaged.

Figure 2. Madagascar: External Sector Developments

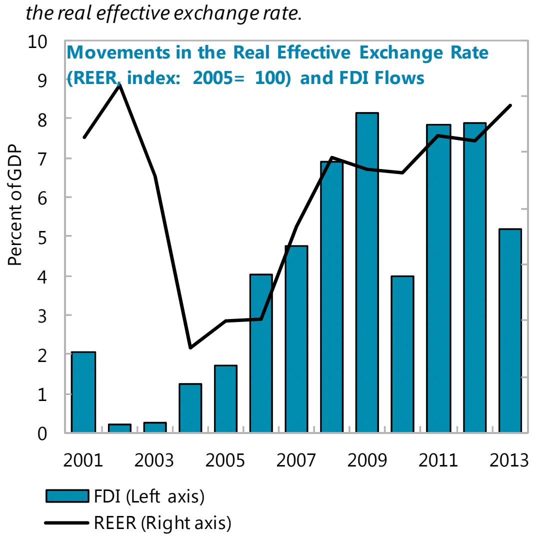
Imports for mining construction and of food and energy put pressure on the current account.



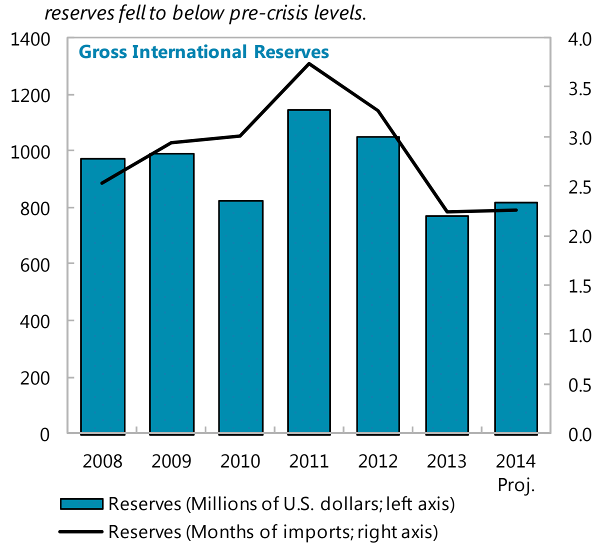
However, FDI and private debt inflows helped to finance these over the period 2007-10.



Large FDI inflows were also associated with appreciation of the real effective exchange rate.

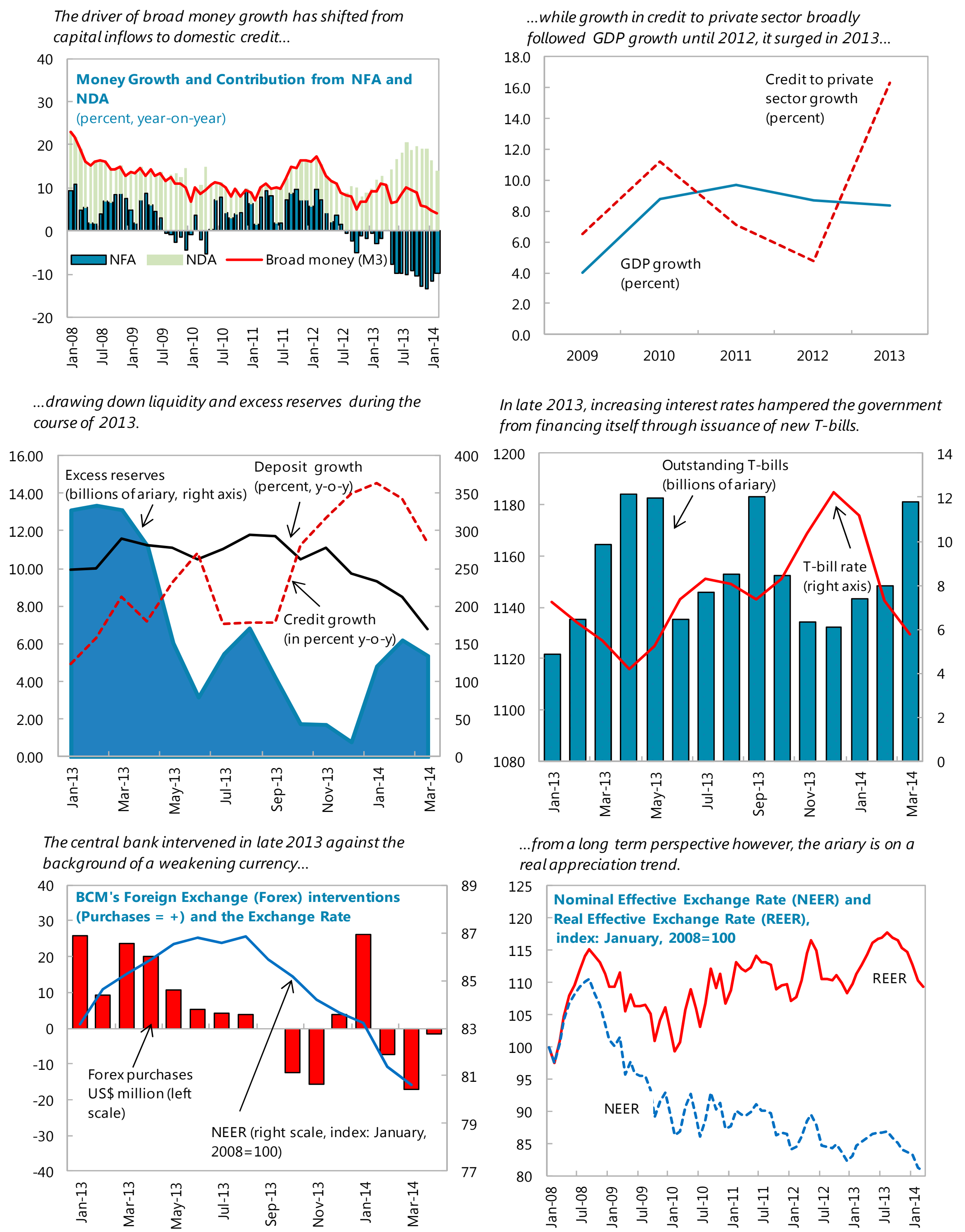


But as FDI flows declined and private debt flows reversed, reserves fell to below pre-crisis levels.



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

Figure 3. Madagascar: Monetary Developments, 2008–14



Sources: Malagasy authorities; and IMF staff estimates.

STRUCTURAL REFORMS

21. The government is preparing a number of actions to advance fiscal management and financial sector development:

- *Fiscal management:* Drawing on the diagnostics of the 2013 Public Expenditure and Financial Accountability (PEFA) assessment and recent Fund TA, the authorities will focus in the short-term on (i) modernizing the information management system; (ii) strengthening capacity for internal control, including for the main governance institutions; (iii) improving budget execution circulars; and (iv) addressing value-for-money issues in procurement. With support from the Fund and other development partners, they will formulate a medium-term PFM strategy over the coming months (MEFP ¶16).

- *Financial sector:* The authorities' reform strategy envisages establishing a framework for financial market development, including improved banking system supervision and financial regulation and improved central bank internal audit and control functions. In addition, to strengthen anti-money laundering (AML) policies, a law on combating the financing of terrorism (CFT) is pending approval by the National Assembly and SAMIFIN (the financial intelligence unit dealing with illegal transnational operations) is proceeding with its application for membership in the Eastern and Southern African Anti-Money Laundering Group (ESSAMLG), once the new law is in place. The effective implementation of AML/CFT will complement efforts to combat corruption (MEFP ¶21).

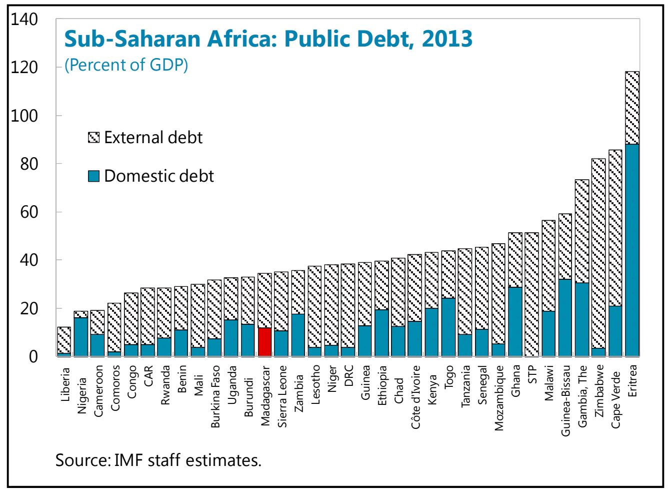
22. Poverty reduction and inclusive growth requires reforms advancing governance and the rule of law and creating a level playing field for the private sector. An interim poverty reduction and growth strategy is expected to be completed in October 2014 (MEFP ¶22). This strategy could serve as input for an eventual donors' conference.

POLICIES, CAPACITY TO REPAY, AND RISKS

23. To monitor implementation, the staff and the authorities have reached understandings on a set of targets (MEFP Table 1).[5] These include ceilings on net bank claims on the central government and the central bank's net domestic assets, and a floor on the central bank's net foreign assets. The indicative targets also include a floor on tax revenue and social priority spending. In addition, the government has committed itself to consult with IMF staff well in advance of signing of any loan contract or loan guarantee on non-concessional terms.

[5] These targets are set and monitored by the authorities and are there to assist in the implementation of their reform plan.

24. Madagascar's risk of public debt distress is assessed to be low, unchanged from the last DSA in 2008 (Supplement I). Madagascar's total public debt is low by sub-Saharan African standards, at just below 35 percent of GDP at end-2013, most of which is contracted on concessional terms (Table 1 of the DSA). This debt level is projected to remain broadly stable over the forecast period, as increased borrowing for infrastructure investment is offset by a recovery in growth, and increased fiscal revenues and donor support. Madagascar's capacity to repay the Fund is adequate (Table 8), with repayments peaking at 0.2 percent of GDP in 2015.



25. The authorities recognize that a medium-term arrangement would be useful to support their development objectives. Structural reforms advancing good governance and the rule of law, creating a level playing field for the private sector, and encouraging foreign investment are essential to support faster and inclusive economic growth. In this context, the authorities have indicated their interest in discussing with Fund staff on a new Fund arrangement supported under the Extended Credit Facility (ECF) later in 2014, once their medium-term economic strategy takes shape (MEFP ¶22).

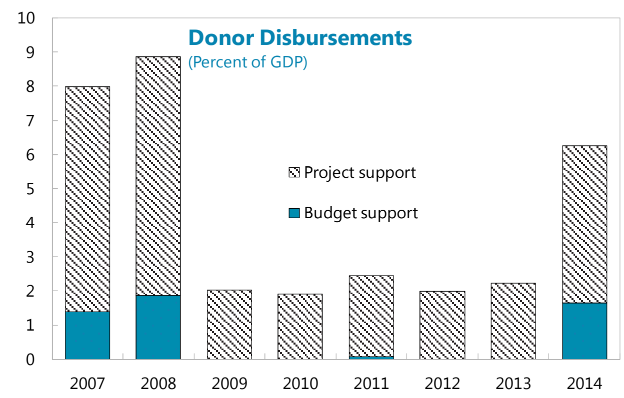
26. The Central Bank has agreed to undergo an updated safeguards assessment update in the near future. The last safeguards assessment was completed in 2008 and identified some vulnerabilities that remain to be addressed. Most important, the central bank has yet to implement International Financial Reporting Standards (IFRS), while audited financial statements were last published for FY2010. Additional steps are also needed to strengthen audit mechanisms (MEFP ¶21). The next safeguards assessment, tentatively scheduled for summer 2014, will follow up on these vulnerabilities, particularly the status of the external audits.

27. There are uncertainties and risks that could disrupt macroeconomic performance in the coming months. The political situation seems settled at present, and President Rajaonarimampianina has emphasized the need to address regional and societal differences, as a way to cement a national reconciliation. Tackling the economic challenges ahead will also test the credibility of the new administration, which will have a bearing on the pace and magnitude of FDI and development partner support.

28. Madagascar has sizeable TA needs. TA was suspended in 2009 as part of the non-recognition by the Fund. The authorities have requested Fund TA in: (i) formulating short-term priority actions and a medium-term reform strategy to improve the PFM system; (ii) advising on reform priorities in tax and customs administration; and (iii) establishing a framework for the development of the financial market and strengthening the central bank. The authorities have also expressed interest in Fund TA in revising the legal framework in line with best international practice in the area of anti-money laundering and combating financing of terrorism. Diagnostic TA missions have already been fielded in the areas of PFM and tax and customs administration, with other requests expected to be catered to in the coming months. In this context, the Regional Technical Assistance Center for Southern Africa (AFRITAC South) has also started to engage with Madagascar.

THE ROLE OF DEVELOPMENT PARTNERS

29. Steadfast support from the development partner community will be critical in assisting the authorities in tackling their development challenges. While disbursements of general budget support have been suspended since 2009, discussions are well underway on a resumption of budgetary and project support for the remainder of 2014. Madagascar faces considerable economic challenges that have become more daunting during the last five years. Successful poverty reducing policies would require higher capital expenditure and spending on social priorities. Development partners, many of whom maintained a presence in Madagascar during the transition years, are now well placed to scale up their interventions in earnest.



Sources: Malagasy authorities; and IMF staff estimates and

STAFF APPRAISAL

30. The new government has rightly put the emphasis on delivering faster and inclusive growth, improved social services, and better governance. During the past five years, economic activity has slowed, with stagnating investment, and social indicators have deteriorated. Governance indicators have also dwindled. Despite these difficult circumstances amid heightened uncertainty, the authorities managed to avoid a macroeconomic crisis. However, limited budgetary resources, as well as costly untargeted subsidy policies, resulted in significant compression of public investment and social spending, with a negative impact on social development. Addressing the high level of poverty remains the critical challenge in Madagascar.

31. The period ahead provides both a significant challenge and an important opportunity for the new government. The economy remains vulnerable, with large balance of payments and fiscal financing gaps that, if not addressed promptly, could get in the way of a robust economic recovery. At the same time, the expectations of the population for a turn-around of economic and social conditions are high. The new government is well placed to seize this opportunity to take forward some key reforms aimed at addressing some of the immediate challenges and alleviating some of the built-up pressures.

32. Staff welcomes the authorities' determination to ease spending compression, clear domestic arrears, and strengthen fiscal management. The legacies of weak tax revenue performance and accumulated budgetary arrears need to be addressed, while at the same time providing room for an increase in critical outlays. On the revenue side, the authorities have identified immediate measures in tax and customs administration aiming to collect the additional tax revenue that can be realistically mobilized. On the expenditure side, the authorities have set aside fiscal resources to increase spending on infrastructure and essential government services. In cooperation with creditors, they are also developing a multi-year strategy to repay existing domestic arrears, including capitalization of debt owed to the central bank. Strengthening PFM systems, including to reverse the slippages that occurred in the last few years, is critical for building confidence in the state and ensuring the efficient allocation of available resources.

33. The decision to return to market-determined prices of fuel products at the pump is a crucial step forward in resolving Madagascar's fiscal challenges. Returning to an automatic price-adjustment mechanism ensuring full cost recovery through appropriately phased price increases should significantly reduce the burden of inefficient subsidies and create significant fiscal space for more productive expenditures. In this context, staff strongly supports the authorities' intention to put in place well-targeted measures to mitigate the impact on the most vulnerable. Measures to realize cost-savings in the operations of the public utility company, JIRAMA, will also be important.

34. Monetary and exchange rate policies should aim to maintain monetary prudence and rebuild foreign exchange reserves. The central bank should continue to allow the official exchange rate to be determined by market forces with its interventions limited to smoothing and to steadily rebuilding foreign exchange reserves.

35. There is an urgent need to revitalize structural reforms. Key reform areas include tax and customs administration, PFM, and measures that build the foundation for a competitive and efficient financial sector. Sustained progress on domestic revenue mobilization and efficient expenditure management will be critical both for creating sufficient and enduring fiscal resources for high-priority social spending and for improving the efficiency of public resources. In the financial sector, further steps to strengthen the Central Bank (notably its supervisory framework), the ultimate steward of the financial system, are welcome.

36. Governance improvements will encourage domestic and foreign investment and promote inclusive growth. This will require building stronger institutions, enabling a level playing field for the private sector, creating incentives that reinforce proper conduct, and providing adequate resources for control and audit of public entities. The authorities' intention to develop a new medium-term poverty reduction and growth strategy is welcome.

37. The role of Madagascar's development partners will be critical. Financing needs are likely to remain large if growth is to be sustained and poverty is to be reduced. Drawing on the authorities' sound macroeconomic framework, development partners are encouraged to scale up their interventions, both in terms of financial support and technical assistance.

38. The outlook for 2014 is subject to risks related to Madagascar's political and economic situation. The new government aims to strengthen national reconciliation by emphasizing the need to address regional and societal differences. Taking an ambitious reform agenda forward will foster enhanced confidence and financial support on the part of both investors and development partners.

39. Staff supports the authorities' request for assistance under the RCF. The new government has committed itself to undertake a well-prioritized and challenging reform agenda for the remainder of 2014 that displays their commitment to macroeconomic stability and to putting the country back on a dynamic growth path. Madagascar has large and urgent balance of payment needs, and Fund support would have a catalytic effect on other external assistance. If implemented effectively, this engagement could be used as a stepping stone for a future arrangement aimed at assisting the authorities in tackling their medium-term challenges.

Table 1. Madagascar: Selected Economic Indicators, 2008-15

	2008	2009	2010	2011	2012	2013	2014	2015
	Estimates						Proj.	Prel. proj.
	(Percent change; unless otherwise indicated)							
National account and prices								
GDP at constant prices	7.2	-3.5	0.1	1.5	2.5	2.4	3.0	4.0
GDP deflator	9.0	7.8	8.6	8.0	6.0	5.8	7.4	7.3
Consumer prices (end of period)	10.1	8.0	10.2	7.5	5.8	6.3	8.5	6.0
External sector								
Export of goods volume	-7.0	-10.1	11.4	21.1	3.9	19.0	9.9	13.7
Import of goods volume	35.8	-29.7	-18.7	2.4	14.0	11.1	6.9	9.1
Terms of trade (deterioration -)	7.6	-25.7	-5.8	1.0	7.3	12.6	3.2	-2.5
Money and credit								
Reserve money	12.9	3.6	15.2	25.6	9.8	-6.1	10.9	...
Broad money (M2)	12.6	10.5	8.6	18.2	6.0	9.3	13.3	...
Net foreign assets [1]	7.8	-4.8	10.2	7.2	-2.0	-14.5	3.7	...
Net domestic assets [1]	5.5	15.6	0.1	9.3	9.7	20.4	10.1	...
Credit to the private sector [1]	12.8	3.3	5.6	3.3	2.3	7.4	6.5	...
	(Percent of GDP)							
Public finance								
Total revenue (excluding grants)	12.1	9.9	11.3	9.8	9.7	9.6	11.1	11.3
Of which : tax revenue	11.8	9.4	9.8	9.6	9.1	9.3	10.9	11.3
Grants	3.4	1.7	1.9	2.0	1.2	1.3	3.7	3.7
Total expenditures	17.4	14.1	14.1	14.1	13.5	16.0	17.0	17.2
Current expenditure	9.7	9.2	9.1	9.9	10.8	12.9	10.8	11.0
Capital expenditure	7.7	4.9	5.0	4.2	2.7	3.1	6.1	6.1
Overall balance (cash basis)	-2.1	-2.5	-1.1	-1.6	-1.4	-3.1	-3.6	-2.8
Savings and investment								
Investment	41.0	35.6	23.5	17.7	17.6	17.6	15.6	16.1
Government	7.7	4.9	5.0	4.2	2.7	2.4	6.1	6.1
Nongovernment	33.2	30.8	18.5	13.5	14.9	15.2	9.5	10.0
Gross domestic savings	16.6	12.0	10.0	6.4	8.1	9.4	9.2	9.2
Public	2.3	1.7	3.5	0.5	-0.8	-3.1	0.6	0.6
Private	14.3	10.3	6.6	5.9	8.9	12.5	8.6	8.6
Gross national savings	20.4	14.5	13.8	10.8	10.9	12.2	12.2	10.4
Public	5.8	2.3	4.2	1.8	0.1	-2.0	4.0	3.9
Private	14.6	12.2	9.6	9.0	10.8	14.2	8.2	6.5
External sector								
Exports of goods, f.o.b.	13.9	12.3	12.3	14.9	15.5	18.3	19.1	19.3
Imports of goods, c.i.f.	40.2	37.4	29.0	29.5	31.3	30.6	30.2	30.7
Current account balance (exc. grants)	-21.4	-21.2	-9.7	-7.6	-7.4	-6.0	-4.9	-7.1
Current account balance (inc. grants)	-20.6	-21.2	-9.7	-6.9	-6.8	-5.4	-3.4	-5.7
Public debt	31.8	33.4	32.0	32.6	33.8	34.2	34.7	34.5
External	24.5	25.7	24.4	24.3	24.3	22.8	24.4	24.9
Domestic	7.3	7.7	7.6	8.3	9.5	11.4	10.3	9.7
	(Units as indicated)							
Gross official reserves (millions of SDRs)	641	626	538	742	682	502	530	627
Months of imports of goods and services	2.5	2.9	2.9	3.7	3.3	2.2	2.3	2.5
Real effective exchange rate								
(period average, percent change)	10.5	-1.6	-0.6	5.8	-0.2	9.5	...	...
GDP per capita (U.S. dollars)	472	417	413	451	441	463	475	490
Nominal GDP at market prices (billions of ariary)	16,081	16,726	18,193	19,955	21,688	23,493	25,996	28,990

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

[1] Growth in percent of beginning of period money stock (M2).

Table 2. Madagascar: National Accounts, 2008–14

	2008	2009	2010	2011	2012	2013	2014
	Estimates						Proj.
	(Percent change)						
Real supply side growth							
Primary sector	2.9	8.5	-3.4	0.7	1.5	0.9	1.4
Agriculture	4.5	10.7	-0.6	-1.2	3.8	-0.1	0.8
Cattle and fishing	1.6	1.8	-8.0	4.2	0.8	3.0	2.8
Forestry	1.0	30.4	0.8	-3.3	-7.4	-3.0	-1.0
Secondary sector	3.6	-7.8	0.2	1.4	3.5	7.5	10.3
Food and drink	7.5	-2.9	8.0	7.2	1.4	2.8	8.6
Export processing zone	1.2	-16.2	-14.0	-0.7	3.5	2.0	13.0
Energy	6.9	-0.4	7.5	-0.9	3.9	4.0	11.0
Extractive industry	9.0	-8.9	55.3	-60.7	58.8	110.0	74.6
Other	-0.7	-11.8	-8.8	1.3	4.4	12.3	4.5
Tertiary sector	8.6	-7.5	0.5	-0.5	3.1	1.9	2.3
Transportation	6.6	-12.3	1.7	-3.6	5.2	1.2	2.7
Services	10.5	-7.4	-0.1	-0.1	2.5	3.0	3.2
Trade	3.3	3.9	-1.4	1.0	1.9	1.0	1.5
Public administration	3.0	-5.0	1.0	1.0	1.1	2.0	1.0
Public works/construction	27.6	-17.7	2.6	3.7	3.4	3.0	1.0
Indirect taxes	16.2	-11.3	8.8	11.5	2.0	3.0	3.0
Real GDP at market prices	7.2	-3.5	0.1	1.5	2.5	2.4	3.0
Nominal demand side composition	(Percent of GDP)						
Resource balance	-24.4	-23.7	-13.4	-11.3	-9.6	-8.2	-6.3
Imports of goods and nonfactor services	50.9	46.0	37.6	38.2	38.9	38.5	38.9
Exports of goods and nonfactor services	26.6	22.4	24.1	26.9	29.3	30.3	32.6
Current account balance (including grants) = (S-I)	-20.6	-21.1	-9.7	-6.9	-6.8	-5.4	-3.4
Consumption	83.4	88.0	90.0	93.6	91.9	90.6	90.8
Government	8.9	8.4	8.2	9.0	10.0	12.2	10.1
Nongovernment	74.5	79.6	81.7	84.6	81.9	78.4	80.7
Investment (I)	41.0	35.6	23.5	17.7	17.6	17.6	15.6
Government	7.7	4.9	5.0	4.2	2.7	2.4	6.1
Nongovernment	33.2	30.8	18.5	13.5	14.9	15.2	9.5
Of which : foreign direct investment	6.9	8.2	4.0	7.8	7.9	5.2	5.4
National savings (S)	20.4	14.5	13.8	10.8	10.9	12.2	12.2
Government	5.8	2.3	4.2	1.8	0.1	-2.0	4.0
Nongovernment	14.6	12.2	9.6	9.0	10.8	14.2	8.2
Memoranda items:							
Exchange rate (ariary/USD, period average)	1,708	1,956	2,090	2,025	2,195	2,207	...
Exchange rate (ariary/USD, end of period)	1,860	1,955	2,146	2,247	2,271	2,236	...
Exchange rate (ariary/SDR, period average)	2,699	3,017	3,189	3,197	3,362	3,354	...
	2,865	3,064	3,305	3,450	3,490	3,444	...
Nominal GDP (at market prices)	16,081	16,726	18,193	19,955	21,688	23,493	25,996
Net factor income	-0.5	-1.1	-1.2	-1.6	-3.2	-3.2	-4.5
Transfers	4.3	3.6	5.0	6.0	6.1	6.0	7.5
Nominal GNP	16,085	16,729	18,197	19,960	21,691	23,496	25,999

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

Table 3. Madagascar: Fiscal Operations of the Central Government, 2008–14

(Billions of Ariary)

	2008	2009	2010	2011	2012	2013	2014	
			Estimates				Budget	Proj.
Total revenue and grants	2,488.1	1,927.4	2,403.5	2,338.9	2,358.1	2,549.6	3,020.1	3,864.6
Total revenue	1,939.8	1,650.0	2,049.1	1,948.6	2,095.2	2,253.5	2,722.1	2,893.4
Tax revenue	1,890.1	1,569.8	1,780.8	1,912.3	1,977.7	2,182.4	2,662.4	2,833.7
Taxes on income, profits, and capital gains	397.2	367.4	428.0	411.8	418.1	555.3	649.7	683.4
Taxes on international trade and transactions	1,007.4	753.4	829.7	997.1	1,048.6	948.4	1,218.7	1,315.0
Domestic taxes on goods and services	882.8	816.4	951.0	915.2	929.1	1,234.0	1,443.7	1,518.7
Non-tax revenue	49.7	80.2	268.3	36.3	117.5	71.1	59.7	59.7
Grants	548.3	277.5	354.5	390.3	262.9	296.1	298.0	971.1
Current grants	127.5	21.0	17.8	17.4	0.6	0.6	0.7	246.2
Capital grants	420.8	256.4	336.7	372.9	262.3	295.5	297.3	724.9
Total expenditure and lending minus repayments	2,803.8	2,353.2	2,562.1	2,816.9	2,926.8	3,750.7	3,429.3	4,408.2
Current expenditure	1,559.0	1,540.2	1,647.6	1,975.0	2,331.6	3,020.2	2,617.8	2,817.9
Wages and salaries	758.9	803.2	944.9	1,060.4	1,167.3	1,341.7	1,589.1	1,602.2
Interest payments	127.3	128.5	147.9	170.3	155.1	158.7	272.2	199.4
Foreign	24.9	33.0	32.6	37.3	37.7	38.7	53.0	53.0
Domestic	102.4	95.5	115.3	133.0	117.3	120.0	219.2	146.4
Other[1]	745.4	514.8	477.7	626.5	836.0	1,117.3	712.8	972.6
of which: Fuel subsidies and related transfers	…	…	…	21.7	230.8	387.5	110.8	206.7
Treasury operations (net)	-74.9	93.7	77.1	117.9	173.2	402.6	43.8	43.8
Capital expenditure	1,244.8	813.0	914.5	841.8	595.2	730.5	811.5	1,590.3
Domestic financed	474.2	361.3	385.0	286.5	165.2	137.9	168.0	391.8
Foreign financed	770.6	451.7	529.5	555.3	430.0	592.7	643.5	1,198.5
Lending minus repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis)	-315.7	-425.8	-158.6	-477.9	-568.7	-1,201.2	-409.2	-543.6
Float	32.2	-1.0	37.6	-13.7	20.0	39.9	0.0	0.0
Variation of domestic arrears (- = increase)	0.0	0.0	0.0	-140.4	-294.1	-515.7	0.0	395.9
Net accumulation of arrears by JIRAMA	0.0	0.0	0.0	0.0	-61.0	-82.0	0.0	74.3
Net accumulation of VAT arrears to mining companies	0.0	0.0	0.0	-110.4	-149.1	-120.9	0.0	0.0
Net accumulation of other VAT arrears	0.0	0.0	0.0	0.0	0.0	-103.0	0.0	51.5
Net accumulation of arrears to the petroleum sector	0.0	0.0	0.0	0.0	0.0	-115.3	0.0	74.3
Net accumulation of debt owed to the central bank	0.0	0.0	0.0	-30.0	-84.0	-94.5	0.0	123.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	72.8
Overall balance (including grants, cash basis)	-345.7	-425.0	-196.2	-324.0	-294.5	-725.4	-409.2	-939.5
Total financing	345.5	425.0	195.7	324.0	294.5	725.2	409.1	939.5
Foreign borrowing (residency principle)	478.3	123.1	132.4	95.9	98.5	233.8	181.2	491.2
External borrowing, Gross	504.6	195.3	192.8	182.5	167.7	297.1	346.1	656.1
Budget support loans	154.8	0.0	0.0	0.0	0.0	0.0	0.0	182.5
Project loans	349.8	195.3	192.8	182.5	167.7	297.1	346.1	473.6
Amortization on a due basis (-)	-26.3	-72.2	-60.4	-86.6	-69.3	-63.4	-164.9	-164.9
Domestic borrowing (residency principle)	-136.0	301.9	63.3	228.1	196.1	491.5	227.9	448.3
Monetary sector[2]	-261.5	313.5	-251.9	369.1	266.2	428.1	168.9	348.0
Of which: Central bank	-78.4	165.1	-217.4	245.4	106.5	271.0	…	113.0
Of which: Central bank recapitalization	…	…	…	…	…	…	…	113.0
Non-monetary sector	-206.4	-43.9	103.9	-41.1	-100.6	63.4	59.0	100.3
Treasury correspondent accounts (net)	312.6	53.9	194.3	-108.4	38.7	-268.1	0.0	0.0
Privatization proceeds	3.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Excess financing (+)	-0.2	0.0	-0.4	0.0	0.0	0.0	0.0	0.0

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

[1] Includes purchase of goods and services, fuel subsidies and related transfers, and other transfers.

[2] Projections for 2014 assume that central bank losses on account of petroleum subsidies will be capitalized through the issuance of Treasury bonds for an amount of MGA 113 billion.

Table 4. Madagascar: Fiscal Operations of the Central Government, 2008–14
(Percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	
	Estimates						Budget	Proj.
Total revenue and grants	15.5	11.5	13.2	11.7	10.9	10.9	11.6	14.9
Revenue	12.1	9.9	11.3	9.8	9.7	9.6	10.5	11.1
Tax revenue	11.8	9.4	9.8	9.6	9.1	9.3	10.2	10.9
Domestic taxes	5.5	4.9	5.2	4.6	4.3	5.3	5.6	5.8
Taxes on international trade	6.3	4.5	4.6	5.0	4.8	4.0	4.7	5.1
Non-tax	0.3	0.5	1.5	0.2	0.5	0.3	0.2	0.2
Grants	3.4	1.7	1.9	2.0	1.2	1.3	1.1	3.7
Current grants	0.8	0.1	0.1	0.1	0.0	0.0	0.0	0.9
Capital grants	2.6	1.5	1.9	1.9	1.2	1.3	1.1	2.8
Expenditures and net lending	17.4	14.1	14.1	14.1	13.5	16.0	13.2	17.0
Current expenditures	9.7	9.2	9.1	9.9	10.8	12.9	10.1	10.8
Wages and salaries	4.7	4.8	5.2	5.3	5.4	5.7	6.1	6.2
Interest	0.8	0.8	0.8	0.9	0.7	0.7	1.0	0.8
Domestic interest	0.6	0.6	0.6	0.7	0.5	0.5	0.8	0.6
Foreign interest	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other[1]	4.6	3.1	2.6	3.1	3.9	4.8	2.7	3.7
of which: Fuel subsidies and related transfers	…	…	…	0.1	1.1	1.6	0.4	0.8
Treasury operations (net)	-0.5	0.6	0.4	0.6	0.8	1.7	0.2	0.2
Capital expenditure	7.7	4.9	5.0	4.2	2.7	3.1	3.1	6.1
Domestic financed expenditure	2.9	2.2	2.1	1.4	0.8	0.6	0.6	1.5
Foreign financed expenditure	4.8	2.7	2.9	2.8	2.0	2.5	2.5	4.6
Overall balance on commitment basis								
Including grants	-2.0	-2.5	-0.9	-2.4	-2.6	-5.1	-1.6	-2.1
Float (-=increase)	0.2	0.0	0.2	-0.1	0.1	0.2	0.0	0.0
Variation of domestic arrears (-=increase)	0.0	0.0	0.0	-0.7	-1.4	-2.2	0.0	1.5
Overall balance on cash basis								
Including grants	-2.1	-2.5	-1.1	-1.6	-1.4	-3.1	-1.6	-3.6
Financing	2.1	2.5	1.1	1.6	1.4	3.1	1.6	3.6
External financing (net)	3.0	0.7	0.7	0.5	0.5	1.0	0.7	1.9
Drawings	3.1	1.2	1.1	0.9	0.8	1.3	1.3	2.5
Budget support	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7
Projects	2.2	1.2	1.1	0.9	0.8	1.3	1.3	1.8
Amortization	-0.2	-0.4	-0.3	-0.4	-0.3	-0.3	-0.6	-0.6
Domestic financing (net)	-0.8	1.8	0.3	1.1	0.9	2.1	0.9	1.7
Monetary sector[2]	-1.6	1.9	-1.4	1.8	1.2	1.8	0.6	1.3
Of which: Central bank	-0.5	1.0	-1.4	1.5	0.7	1.7	…	0.7
Of which: Central bank recapitalization	…	…	…	…	…	…	…	0.7
Non-monetary sector	-1.3	-0.3	0.6	-0.2	-0.5	0.3	0.2	0.4
Treasury correspondent accounts (net)	1.9	0.3	1.1	-0.5	0.2	-1.1	0.0	0.0
Fiscal gap (+ excess financing)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:								
Stock of budgetary arrears (percent of GDP)[3]	…	…	…	0.4	1.7	3.8	…	1.9
Nominal GDP	16,081	16,726	18,193	19,955	21,688	23,493	25,996	25,996

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

[1] Includes purchase of goods and services, fuel subsidies and related transfers, and other transfers.

[2] Projections for 2014 assume that central bank losses on account of petroleum subsidies will be capitalized through the issuance of Treasury bonds.

[3] Figures on the estimates for the stock of arrears are calculated based on the preliminary estimate for end-2013. These numbers are subject to change with the ongoing audit of arrears.

Table 5. Madagascar: Balance of Payments, 2008–18

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Estimates						Projections				
	(Millions of SDRs)										
Current account	-1,226.3	-1,172.5	-554.3	-431.0	-435.9	-377.6	-243.1	-429.3	-446.8	-432.3	-423.6
Trade balance of goods and services	-1,451.0	-1,312.0	-767.2	-705.7	-616.7	-573.2	-459.9	-522.0	-596.2	-639.5	-662.2
Exports, f.o.b.	1,581.9	1,240.9	1,377.5	1,676.5	1,890.6	2,121.7	2,364.3	2,489.8	2,626.9	2,815.6	3,078.6
Imports, f.o.b.	-3,032.8	-2,552.9	-2,144.6	-2,382.2	-2,507.3	-2,694.9	-2,824.2	-3,011.8	-3,223.1	-3,455.1	-3,740.8
Oil imports	-365.9	-202.3	-263.2	-397.4	-462.7	-437.5	-498.0	-477.4	-470.8	-471.7	-478.8
Food	-78.8	-100.8	-113.1	-155.6	-167.6	-262.8	-231.1	-215.2	-220.9	-227.3	-234.1
Intermediate goods	-404.8	-281.4	-279.5	-342.8	-365.6	-382.8	-313.5	-323.7	-336.3	-348.6	-362.0
Capital goods	-665.7	-896.8	-498.7	-329.9	-304.6	-289.5	-257.0	-297.3	-344.8	-399.3	-463.1
Other imports	-1,517.7	-1,968.5	-1,488.9	-1,486.3	-1,511.3	-1,611.9	-1,781.6	-1,995.4	-2,195.2	-2,407.5	-2,665.9
Services (net)	-246.1	-231.0	-62.4	-74.1	99.3	-32.3	11.8	-7.4	-43.1	-78.4	-116.9
Receipts	753.0	558.7	675.3	743.7	889.4	839.5	976.0	1,022.0	1,073.9	1,128.2	1,184.9
Payments	-999.0	-789.7	-737.8	-817.9	-790.2	-871.8	-964.2	-1,029.4	-1,117.1	-1,206.6	-1,301.9
Income (net)	-31.7	-59.3	-70.4	-98.4	-209.6	-221.6	-325.5	-469.4	-448.5	-426.1	-431.2
Receipts	39.8	22.1	41.1	54.0	22.2	11.8	17.6	38.5	43.5	49.6	55.2
Payments	-71.5	-81.4	-111.5	-152.3	-231.8	-233.5	-343.1	-507.9	-492.1	-475.7	-486.4
Of which: interest on public debt	-9.0	-13.4	-10.3	-11.7	-16.0	-11.9	-24.2	-27.8	-34.0	-38.2	-41.7
Current transfers (net)	256.4	198.8	283.3	373.1	390.4	417.2	542.2	562.1	598.0	633.3	669.8
Official transfers	50.6	3.9	1.4	41.1	44.2	44.5	111.4	111.1	118.2	125.2	132.4
Of which : Budget aid	n.a.	n.a.	n.a.	5.2	0.0	0.0	68.7	66.4	70.7	74.9	79.2
Private transfers	205.8	194.9	281.9	332.0	346.2	372.7	430.8	450.9	479.7	508.1	537.4
Capital and financial account	1,292.5	1,156.9	599.0	511.8	384.8	220.7	254.2	213.1	226.5	242.4	268.6
Capital account	156.5	49.0	49.1	91.4	78.1	89.5	202.3	211.8	225.3	238.6	252.4
Of which : Project grant	215.9	49.0	49.1	91.4	78.1	89.5	202.3	211.8	225.3	238.6	252.4
Financial account	1,149.6	1,047.5	569.7	458.8	339.8	133.0	58.4	1.3	1.2	3.8	16.2
Foreign direct and portfolio investment	410.7	452.0	227.2	489.1	507.7	362.8	391.1	384.4	408.9	433.1	458.1
Other investment	738.9	595.5	342.4	-30.3	-167.9	-229.8	-332.7	-383.1	-407.7	-429.2	-441.9
Government	241.2	40.6	40.9	30.2	-2.0	45.5	111.6	121.4	128.2	138.6	159.9
Drawing	255.9	64.1	60.1	57.0	50.1	67.3	183.1	196.6	209.2	221.5	236.8
Project drawings	200.5	64.1	60.1	57.0	50.1	67.3	132.2	138.3	147.2	155.9	167.4
Budgetary support	61.6	0.0	0.0	0.0	0.0	0.0	50.9	58.3	62.0	65.7	69.5
Amortization	-14.7	-23.5	-19.3	-26.8	-52.1	-21.9	-71.6	-75.2	-81.0	-83.0	-77.0
Monetary authority and private sector	49.5	311.3	-113.2	-58.1	-132.8	-118.1	-161.9	-171.5	-184.0	-197.0	-210.4
Banks	-22.5	-7.1	-29.9	17.6	-12.3	34.8	21.7	0.0	0.0	0.0	0.0
Other (including unrepatriated export revenues)	447.5	254.8	444.7	-20.0	-20.8	-192.0	-304.0	-333.0	-351.8	-370.8	-391.4
Errors and omissions	-13.6	60.4	-19.8	-38.4	-33.1	-1.8	-6.6	0.0	0.0	0.0	0.0
Overall balance	66.1	-15.6	44.8	80.7	-51.2	-156.9	11.1	-216.3	-220.2	-189.9	-155.0
Financing	-66.0	15.6	-44.8	-80.7	51.2	156.9	-40.0	-109.8	-125.7	-120.0	-77.4
Central bank (net; increase = –)	-66.1	15.8	86.5	-206.0	55.3	173.4	-40.0	-109.8	-125.7	-120.0	-77.4
Use of IMF credit (net)	37.3	0.0	-1.1	-2.3	-4.4	-6.2	-12.9	-11.9	-1.1	-8.3	-5.9
Other assets, net (increase = –)	-103.5	15.8	87.7	-203.8	59.7	179.5	-27.1	-97.9	-124.6	-111.7	-71.4
Financing gap	0	0	0	0	0	0	29	326	346	310	232
	(Percent of GDP; unless otherwise indicated)										
Memorandum items:											
Grants (percent of GDP)	3.6	0.9	0.9	1.5	1.2	1.3	3.7	3.7	3.7	3.7	3.7
Loans (percent of GDP)	4.4	1.2	1.1	0.9	0.8	1.0	2.5	2.6	2.6	2.6	2.6
Direct investment (percent of GDP)	6.9	8.2	4.0	7.8	7.9	5.2	5.4	5.1	5.1	5.1	5.1
Current account (percent of GDP)											
Excluding net official transfers	-21.4	-21.2	-9.7	-7.6	-7.4	-6.0	-4.9	-7.1	-7.0	-6.5	-6.1
Including net official transfers	-20.6	-21.2	-9.7	-6.9	-6.8	-5.4	-3.4	-5.7	-5.5	-5.1	-4.7
Gross official reserves	641	626	538	742	682	502	530	627	752	864	935
Months of imports of goods and nonfactor services	2.5	2.9	2.9	3.7	3.3	2.2	2.3	2.5	2.8	3.0	3.0
Months of imports, exc. large mining projects	3.1	3.5	3.2	4.1	3.3	2.3	2.4	2.6	2.9	3.1	3.2
Exchange rate (ariary/US$, period average)	1,708	1,956	2,090	2,025	2,195	2,207	...	...	...	...	...

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

Table 6. Madagascar: Monetary Accounts, 2008–14[1]
(Billions of Ariary, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014
			Estimates				Proj.
Net foreign assets	2,149	1,982	2,371	2,692	2,595	1,840	2,056
Net foreign assets (BCM)	1,635	1,400	1,644	1,996	1,844	1,219	1,466
Net foreign assets (deposit money banks)	514	583	727	696	751	621	590
Net domestic assets	1,577	2,123	2,128	2,545	3,005	4,067	4,661
Domestic credit	1,680	2,125	2,100	2,561	3,045	3,956	4,770
Net credit to government (budget)	-137	169	-62	246	604	1,131	1,479
Credit to the economy	1,817	1,957	2,162	2,315	2,440	2,824	3,290
Credit to public enterprises	24	42	36	35	53	54	89
Credit to private sector	1,776	1,892	2,104	2,254	2,361	2,745	3,130
Other credits	17	22	21	26	26	25	71
Other items (net; asset = +)[2]	-103	-2	28	-16	-40	111	-109
Money and quasi-money (M3)	3,726	4,106	4,498	5,237	5,599	5,907	6,717
Foreign currency deposits	523	573	666	708	804	666	790
Broad money (M2)	3,169	3,501	3,802	4,494	4,763	5,204	5,894
Currency in circulation	936	1,011	1,174	1,478	1,517	1,608	1,777
Demand deposits in local currency	1,342	1,392	1,444	1,769	1,870	1,944	2,220
Quasi-money including time deposits	891	1,098	1,183	1,247	1,376	1,653	1,897
	(Percentage change relative to broad money at beginning of period)						
Net foreign assets	7.8	-4.8	10.2	7.2	-2.0	-14.5	3.7
Net domestic assets	5.5	15.6	0.1	9.3	9.7	20.4	10.1
Domestic credit	4.6	12.7	-0.7	10.3	10.2	17.5	13.8
Net credit to government (budget)	-8.5	8.7	-6.1	6.9	7.5	10.1	5.9
Credit to the economy	13.1	4.0	5.4	3.4	2.6	7.4	7.9
Credit to public enterprises	0.0	0.5	-0.2	0.0	0.4	0.0	0.6
Credit to private sector	12.8	3.3	5.6	3.3	2.3	7.4	6.5
Other items (net; asset = +)[3]	1.0	2.9	0.8	-1.0	-0.5	2.9	-3.7
	(Percentage change from previous period)						
Broad money (M2)	12.6	10.5	8.6	18.2	6.0	9.3	13.3
Currency in circulation	11.4	7.9	16.1	25.9	2.7	6.0	10.5
Demand deposits in local currency	8.8	3.7	3.7	22.5	5.7	3.9	14.2
Quasi-money in local currency	54.3	23.3	7.7	5.4	10.3	20.1	14.8
Credit to the private sector (in nominal terms)	29.5	6.5	11.2	7.1	4.8	16.2	14.0
Credit to the private sector (in real terms)	17.7	-1.4	0.9	-0.4	-1.0	9.4	5.1
Memorandum items:							
Money multiplier (M3/reserves)	2.35	2.50	2.38	2.20	2.14	2.41	2.47
Velocity of money (GDP/end-of-period M3)	4.32	4.07	4.04	3.81	3.87	3.98	3.87

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

[1] End of period.

[2] Include public enterprises and the local government.

[3] Including valuation.

Table 7. Madagascar: Balance Sheet of the Central Bank, 2008–14[1]

(Billions of Ariary; unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014
	Estimates						Proj.
Net foreign assets	1,635	1,400	1,644	1,996	1,844	1,219	1,466
Gross foreign assets	1,847	1,919	2,192	2,551	2,387	1,734	1,975
Gross foreign liabilities	-212	-519	-548	-555	-543	-515	-509
Net domestic assets	-49	243	249	382	768	1,234	1,255
Credit to government (net)	-141	24	-193	52	159	430	543
Claims on public enterprises	5	6	7	8	9	9	9
Claims on banks: Liquidity operations (+ = injection)	-256	-203	-112	-278	-111	-111	0
Other items (net; asset +)	343	417	547	600	712	906	703
Reserve money	1,585	1,643	1,893	2,378	2,612	2,453	2,721
Currency outside banks	936	1,011	1,174	1,478	1,517	1,608	1,777
Bank reserves	633	632	719	900	1,095	844	944
Currency in banks	75	97	92	93	122	153	135
Deposits	558	535	627	807	972	691	809
Memorandum items:							
Cumulative annual flow							
Net foreign assets	237	-235	244	352	-153	-625	248
Millions of SDRs	68	-111	41	83	-54	-174	40
Net domestic assets[2]	300	292	6	133	386	466	21
Credit to government (net)	-78	165	-217	245	107	271	113
Reserve money	181	58	250	485	234	-159	269

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

[1] End of period.

[2] Includes public enterprises and the local government.

Table 8. Madagascar: Selected Financial Soundness Indicators, 2009–13 [1]
(Ratios, Percent)

	2009 Dec	2010 Dec	2011 Dec	2012 Dec	2013 Mar	2013 June	2013 Sep	2013 Dec
Capital Adequacy								
Regulatory capital to risk-weighted assets	14.6	14.4	15.3	15.2	15.4	16.1	15.4	14.5
Regulatory Tier 1 capital to risk-weighted assets	7.2	7.6	7.6	7.7	7.6	8.4	…	…
Non-performing loans net of provisions to capital	20.2	19.2	18.0	13.5	10.9	11.1	17.5	18.4
Capital to assets	7.1	7.4	7.2	7.2	7.2	8.0	7.8	7.7
Tier 1 to assets	7.2	7.6	7.6	7.7	7.6	8.4	…	…
Asset Quality								
Non-performing loans to total gross loans	11.3	13.1	14.6	14.2	13.9	13.3	14.0	13.8
Earnings and Profitability								
Return on assets	1.6	1.5	1.8	2.0	1.9	2.1	2.4	2.4
Return on equity	21.9	19.9	22.9	25.4	23.9	26.1	30.2	30.2
Interest margin to gross income	60.7	62.1	63.2	63.6	63.7	63.6	64.7	64
Non-interest expenses to gross income	50.9	52.3	52.8	56.0	57.9	57.1	55.9	54.1
Liquidity								
Liquid assets to total assets (liquid asset ratio)	46.9	45.9	49.7	50.4	51.3	45.1	45.7	43.2
Liquid assets to short-term liabilities	69.7	67.8	71.0	74.1	76.4	66.0	66.9	63.7
Sensitivity to Market Risk								
Net open position in foreign exchange to capital	15.4	15.1	14.5	11.9	13.2	9.6	14.8	17.6
Trading income to total income	97.5	97.9	97.4	97.7	98.0	97.5	97.4	97.5
Personnel expenses to non-interest expenses	36.6	37.7	37.2	38.2	40.1	40.4	39.7	39.4
Spread between reference lending and deposit rates	10.6	11.2	11.6	11.9	12.5	5.4	5.5	17.7
Customer deposits to total (non-interbank) loans	183.5	175.0	188.2	188.3	191.6	169.2	165.4	158
Foreign currency-denominated loans to total loans	4.9	4.7	7.3	5.9	5.8	5.1	5.5	6.3
Foreign currency-denominated liabilities to total liabilities	17.8	19.3	18.3	17.5	17.6	15.3	15.0	16.3
Net open position in equities to capital	6.6	6.3	6.8	6.0	5.7	5.9	6.4	6.6

Sources: Malagasy authorities.

[1] Ratios only concern banking sector.

Table 9. Indicators of Capacity to Repay the Fund, 2014–24

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	(Millions of SDRs)										
Fund obligations based on existing credit											
Principal	6.4	11.7	10.6	8.3	5.9	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Fund obligations based on existing and prospective credit											
Principal	6.4	11.7	10.6	8.3	5.9	3.1	6.1	6.1	6.1	6.1	3.1
Charges and interest	0.0	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total obligations based on existing and prospective credit											
Millions of SDRs	6.5	11.9	10.8	8.4	6.0	3.2	6.2	6.2	6.2	6.2	3.1
Billions of Ariary	23.2	45.6	42.8	34.6	25.7	14.0	28.3	29.1	29.8	30.7	15.9
Percent of exports of goods and services	0.3	0.5	0.4	0.3	0.2	0.1	0.2	0.2	0.1	0.1	0.1
Percent of debt service	7.9	14.1	12.7	9.2	6.2	3.2	6.4	6.8	6.8	6.4	3.0
Percent of GDP	0.1	0.2	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.0	0.0
Percent of government revenue	0.8	1.4	1.1	0.8	0.5	0.3	0.5	0.4	0.4	0.4	0.2
Percent of quota	5.3	9.8	8.8	6.9	4.9	2.6	5.1	5.1	5.1	5.0	2.5
Outstanding IMF credit based on existing and prospective drawings											
Millions of SDRs	67.0	55.2	44.6	36.4	30.5	27.4	21.3	15.2	9.1	3.0	0.0
Billions of Ariary	240.0	210.9	177.0	149.9	130.3	121.6	97.4	71.6	44.2	15.2	0.0
Percent of exports of goods and services	2.8	2.2	1.7	1.3	1.0	0.8	0.6	0.4	0.2	0.1	0.0
Percent of debt service	82.0	65.3	52.7	39.8	31.2	28.0	22.2	16.7	10.1	3.1	0.0
Percent of GDP	0.9	0.7	0.6	0.4	0.3	0.3	0.2	0.1	0.1	0.0	0.0
Percent of government revenue	8.3	6.4	4.7	3.5	2.8	2.3	1.6	1.1	0.6	0.2	0.0
Percent of quota	54.8	45.2	36.5	29.8	25.0	22.5	17.5	12.5	7.5	2.5	0.0
Net use of IMF credit (millions of SDRs)	24.1	-11.7	-10.6	-8.3	-5.9	-3.1	-6.1	-6.1	-6.1	-6.1	-3.1
Disbursements	30.5	0	0	0	0	0	0	0	0	0	0
Repayments and repurchases	6.4	11.7	10.6	8.3	5.9	3.1	6.1	6.1	6.1	6.1	3.1
Memorandum items:	(Billions of Ariary, unless otherwise indicated)										
Exports of goods and services (millions of SDRs)	2,364	2,490	2,627	2,816	3,079	3,384	3,715	4,093	4,527	5,024	5,434
Debt service	292.8	322.7	336.2	376.7	417.9	434.1	439.4	429.5	439.3	481.6	523.0
Nominal GDP (at market prices)	25,996	28,990	32,045	35,248	38,672	42,448	46,582	51,109	56,099	61,563	67,574
Government revenue	2,893	3,276	3,749	4,230	4,737	5,348	6,009	6,746	7,517	8,373	9,325
Quota (millions of SDRs)	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2

Source: IMF staff estimates and projections.

[1] Total debt service (domestic and external) includes IMF repurchases and repayments. Domestic debt service includes interest rates only due to non-availability of data on projected amortization of domestic debt instruments.

Table 10. Madagascar: Millennium Development Goals[1]

	1990	1995	2000	2005	2012	2015 target	Status [2]
Goal 1: Eradicate extreme poverty and hunger							Low progress
Employment to population ratio, 15+, total (%)	84	84	85	84	86		
Employment to population ratio, ages 15-24, total (%)	71	71	73	72	75		
GDP per person employed (constant 1990 PPP $)	1,714	1,441	1,494	1,426	1,348		Medium progress
Income share held by lowest 20%	...	6	5	6	5		
Malnutrition prevalence, weight for age (% of children under 5)	36	30	...	37	...	19	Unlikely to meet
Poverty gap at $1.25 a day (PPP) (%)	...	33	41	27	43		
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	...	72	76	68	81	35	Unlikely to meet
Vulnerable employment, total (% of total employment)	...	84	...	86	...		
Goal 2: Achieve universal primary education							Low progress
Literacy rate, youth female (% of females ages 15-24)	...	...	68	...	...	100	Unlikely to meet
Literacy rate, youth male (% of males ages 15-24)	...	...	73	...	...	100	Unlikely to meet
Persistence to last grade of primary, total (% of cohort)	34	27	36	36	41	100	Unlikely to meet
Primary completion rate, total (% of relevant age group)	35	31	36	58	70	100	Unlikely to meet
Adjusted net enrollment rate, primary (% of primary school age children)	67	56	65	77	...	100	Unlikely to meet
Goal 3: Promote gender equality and empower women							High progress
Proportion of seats held by women in national parliaments (%)	...	4	8	7	18	50	Likely to meet
Ratio of female to male primary enrollment (%)	96	104	96	96	99	100	Likely to meet
Ratio of female to male secondary enrollment (%)	94	...	...	96	95	100	Likely to meet
Ratio of female to male tertiary enrollment (%)	77	83	87	89	92	100	Likely to meet
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	...	30.8	...	37.7	35.4	50	Medium progress
Goal 4: Reduce child mortality							Low progress
Immunization, measles (% of children ages 12-23 months)	47	55	57	74	69	100	Unlikely to meet
Mortality rate, infant (per 1,000 live births)	97	85	69	54	41	31	Unlikely to meet
Mortality rate, under-5 (per 1,000 live births)	159	137	109	81	58	53	Unlikely to meet
Goal 5: Improve maternal health							Medium progress
Adolescent fertility rate (births per 1,000 women ages 15-19)	150	153	152	140	125		Medium progress
Births attended by skilled health staff (% of total)	57	47	46	51	...		Medium progress
Contraceptive prevalence (% of women ages 15-49)	17	19	19	27	...		Medium progress
Maternal mortality ratio (modeled estimate, per 100,000 live births)	640	550	400	310	240	122	Unlikely to meet
Pregnant women receiving prenatal care (%)	78	77	71	80	...	100	Medium progress
Unmet need for contraception (% of married women ages 15-49)	32	26	...	24	...		Medium progress
Goal 6: Combat HIV/AIDS, malaria, and other diseases							Medium progress
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	...	...	61	34	...		Low progress
Incidence of tuberculosis (per 100,000 people)	391	335	293	262	234		Medium progress
Prevalence of HIV, female (% ages 15-24)	...	...	...	...	0.3		
Prevalence of HIV, male (% ages 15-24)	...	...	...	...	0.3		
Prevalence of HIV, total (% of population ages 15-49)	0.2	0.7	0.7	0.7	0.5		Medium progress
Tuberculosis case detection rate (%, all forms)	14	48	35	40	49		Medium progress
Goal 7: Ensure environmental sustainability							Medium progress
Forest area (% of land area)	23.5	23.1	22.6	22.1	21.5		
Improved sanitation facilities (% of population with access)	8	9	11	12	14	54	Unlikely to meet
Improved water source (% of population with access)	29	34	38	42	48	68	Unlikely to meet
Goal 8: Develop a global partnership for development							
Net ODA received per capita (current US$)	34	22	20	50	20		
Debt service (PPG and IMF only, % of exports of goods, services and primary income)	44	7	7	5	3		High progress
Internet users (per 100 people)	0	0	0	1	2		Medium progress
Mobile cellular subscriptions (per 100 people)	0	0	0	3	39		High progress
Telephone lines (per 100 people)	0	0	0	1	1		Medium progress

Source: World Bank, *World Development Indicators* (October 2013).

[1] Figures may refer to the most recent period available, other than those specified in the header.

[2] Status according to "Enquête Nationale sur le Suivi des Objectifs du Millénarie pour le Développement à Madagascar", report published in 2014 by l'Institut National de la Statistique (INSTAT) in cooperation with les Partenaires Techniques et Financiers. The report, based on data for 2012-13, is available on //www.instat.mg

Appendix I. Letter of Intent

Antananarivo, Madagascar
June 3, 2014

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

Dear Madam Managing Director:

1. The past five years of transition and uncertainty have been difficult. However, following the presidential elections and the appointment of a new government, we are determined to start tackling Madagascar's urgent economic and social challenges. The government's objective is to create a solid foundation for faster growth and poverty reduction.

2. Key economic priorities include promoting a stable social and political environment that supports the economic recovery and maintaining macroeconomic and financial stability. We will also work towards developing a medium-term plan to bring the Malagasy economy back on the path of sustainable growth. To assist us in this, we are counting on the financial support of the international community, which is needed if our efforts are to succeed in materially improving living standards and employment prospects in the next few years. We are asking the International Monetary Fund to provide immediate support in the form of a disbursement under the Rapid Credit Facility (RCF) in an amount equivalent to 25 percent of quota, or SDR 30.55 million that would be disbursed to the Central Bank of Madagascar.

3. The attached Memorandum of Economic and Financial Policies (MEFP) describe the policies that we plan to implement over the next six months. The government is convinced that the policies and measures included in this memorandum will help to address our balance of payment difficulties and advance our poverty reduction and growth objectives. It will consult with IMF staff at its own initiative or at the request of the IMF Managing Director prior to the adoption of any additional measures that it may deem necessary or in the event of changes to the policies set forth in this Memorandum. The government also undertakes to cooperate fully with the IMF to achieve its policy objectives and not to introduce measures or policies that would compound Madagascar's balance of payment difficulties. The Central Bank of Madagascar is committed to undergo a safeguards assessment update by the IMF before a successor Fund arrangement is in place.

4. The Malagasy authorities agree to the publication of this Letter of Intent (LOI) and the attached Memorandum of Economic Policies (MEFP) and Technical Memorandum of Understanding (TMU), as well as the IMF staff report related to the request for a disbursement under the Rapid

Credit Facility (RCF) and the Debt Sustainability Analysis. We hereby authorize their publication and posting on the IMF website after approval by the Executive Board of the IMF.

Sincerely yours,

/s/	/s/
Mr. Jean Razafindravonona	Ms. Vonimanitra Razafimbelo
Minister	Governor (acting)
Ministry of Finance and Budget	Central Bank of Madagascar
Madagascar	Madagascar

Attachments:
- Memorandum of Economic and Financial Policies
- Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies
June 3, 2014

Introduction

1. **Context.** Madagascar has gone through a five-year political crisis with strong disruptions affecting the economy. Economic activity slowed, investment stagnated, and social indicators deteriorated. About 90 percent of the population lives with less than US$2 a day (adjusted for purchasing-power parity), making poverty a critical issue for Madagascar. Social hardships were aggravated by the suspension of budget support, which forced the authorities to reduce social and infrastructure spending. In addition, domestic arrears were accumulated. However, the transition government has been able to maintain macroeconomic and financial stability thanks to prudent fiscal and monetary policies. Following presidential and parliamentary elections in 2013 and the nomination of a prime minister and appointment of the new government in April 2014, Madagascar stands ready to engage in an economic recovery and social development program with the support of development partners.

Economic Developments 2009–13

2. **In 2009, the country experienced a strong GDP contraction of 3.5 percent due to the uncertain environment and the suspension of budget support from development partners**. Growth continued to stagnate due to lingering uncertainty, loss of preferential market access, capital outflows, and natural disasters. A modest recovery started in 2011 with average growth of 2.1 percent a year over 2011–13 mainly supported by two large world-class mining projects. Furthermore, most social indicators also stagnated or deteriorated despite the pursuit of some social and humanitarian projects financed by donors. The weak economic growth combined with the deterioration of social conditions resulted in an increasing proportion of the population living below the poverty line.

3. **The difficult economic environment had negative effects on fiscal indicators.** In addition to declining support from our development partners (who financed 40–50 percent of the budget before 2009), tax revenue performance was weak. Strict budget control resulted in a compression of fiscal spending. However, given lack of cash resources, arrears were accumulated. Preliminary estimates, pending the result of an ongoing comprehensive audit, suggest that the stock of central government domestic arrears amounted to 3.8 percent of GDP at end–2013. The stock of public debt at end–2013 amounted to 35 percent of GDP.

4. **Tax revenue collections have underperformed significantly compared to previous years.** Total tax revenue declined from 11.8 percent of GDP in 2008 to an estimated 9.3 percent of GDP in 2013, after taking into account VAT refund obligations. This reflects weak economic activity, an increasing informal economy, and significant challenges in tax and customs administration.

Direct taxes declined steadily over the period while indirect taxes stagnated.

5. **Expenditure cuts have been significant with negative impacts on social and development indicators**. Against a background of limited fiscal resources, infrastructure projects and social protection programs have had to be curtailed, setting back progress on many of the Millennium Development Goals (MDGs). This has also had a significant effect on the functioning of government, including in terms of governance institutions.

6. **To mitigate the negative impact from rising international oil prices, the government froze prices of fuel products at the pump starting in 2011.** The associated annual budgetary subsidy cost is about 1.5 percent of GDP to compensate importers for the shortfalls. In addition, the national utility company JIRAMA (electricity and water) has been operating at a significant loss for many years due to operational inefficiencies, tariff adjustments that have remained below cost recovery, and a deteriorating capital stock. As a result, arrears have accumulated to electricity suppliers in 2011, which have added to the fiscal pressures of the central government.

7. **Monetary aggregates have been kept broadly in check and inflation has by and large remained in single digits for the period.** After peaking at 16.4 percent in 2011, broad money growth (M3) declined rapidly to 5.5 percent in 2013. While subdued demand kept credit to private sector growing more or less in line with nominal GDP through 2012, it accelerated in 2013 mainly due to overdrafts, including those related to imports of petroleum products, and to a lesser extent medium-term (working capital) and long-term (working capital and financing of housing construction) borrowing. The banking sector has remained reasonably profitable and liquid.

8. **The mining sector is an important component of balance of payment flows**. The current account deficit peaked at 21 percent of GDP in 2009, on the back of associated imports of investment goods, financed by FDI inflows. It has since declined to 5.3 percent of GDP at end– 2013. After peaking at 3.7 months import cover at end–2011, foreign exchange reserves started to decrease in 2012. The decline accelerated in 2013 due to agreed subsidies on petroleum product imports and rapidly increasing food imports. This took place against a background of decreasing FDI and persistent net outflows from private sector transactions that increased ahead of the 2013 elections. As a result, foreign exchange reserves fell to 2.2 months import cover at end-March 2014.

9. **The real effective exchange has appreciated in recent years,** as price increases have been faster compared to price increases in trading partner countries. While the nominal effective exchange rate depreciated by about 19 percent between end–2008 and end–2013, it appreciated by about 5 percent in real terms.

Policies for 2014

10. **The government's immediate objective is to create a solid foundation for faster growth and poverty reduction.** In this context, priorities for 2014 are: (i) promoting a stable social and political environment that supports the economic recovery; (ii) maintaining macroeconomic

and financial stability; (iii) enhancing food security and the safety of people; (iv) expanding access to health services and education; and (v) strengthening social protection. A medium-term plan will also be developed to bring the Malagasy economy back on the path of durable growth conducive to sustainable and inclusive development and to re-engage with the international community. Improved coordination with our development partners and disbursements of external financing will help support the reform process.

11. **The overall resource envelope of the 2014 budget is insufficient to address Madagascar's urgent expenditure needs.** The budget law envisages an overall deficit of 1.6 percent of GDP in 2014, based on continued expenditure compression (a steady trend decline in capital spending and budgeted non-wage current spending 40 percent less than expenditure commitments in 2013). The resource envelope does not allow for the clearance of arrears, including VAT refunds, fuel subsidies, JIRAMA-related arrears, and debt owed to the central bank.

12. **A supplementary budget will be submitted to the National Assembly in July 2014.** This supplementary budget law takes into account additional tax revenue that can be realistically mobilized as well as additional budget support by our development partners. On the revenue side, we have initiated internal diagnostics of both the tax and customs administrations (supported by technical assistance). Measures that we intend to take in the short term include:

- Improved controls to reduce the under invoicing of imported goods (in accordance with WTO rules), after prior consultations with private sector representatives, in particular GEM, SIM, and FIVMPAMA;

- Increased scanner detection and physical inspection of imported goods to deter fraudulent declarations;

- Enhanced enforcement of invoiced sales and licensing of commercial and sectoral activities, primarily through increased inspection on the ground and enforcement of excise obligations;

- Increased collaboration and information sharing between the tax and customs administrations.

Taking into account these measures, we expect overall tax collections (cumulative from the beginning of 2014) to amount to MGA 1,114 billion at end-June, 1,707 billion at end-September, and MGA 2,834 billion at end-December 2014.

13. **This supplementary budget envisages a spending increase on infrastructure as well as on essential government services in line with our priorities.** We attach particular importance to ensure that social outlays are adequately provided for. In particular, we are committed to ensure that outlays on education, health, and nutrition will be at least (cumulative from the beginning of 2014) MGA 64.8 billion at end-June, 108.7 billion at end-September, and MGA 215.4 billion at end-December 2014.

14. **The government is committed to avoid the accumulation of new domestic budgetary arrears and to settle the stock of existing arrears as soon as practicable**. Given the size of

existing arrears, a three-year strategy to repay existing arrears will be developed, which includes an appropriation in the 2014 supplementary budget of MGA 200 billion for partial clearance of arrears. Bilateral discussions with creditors have started to ensure that repayment agreements are consistent with this overall strategy. In addition, a strategy to finance a repurchasing of this debt will be considered, while respecting the concessionality guidelines. With regards to the central bank, it was agreed to settle outstanding obligations through securitization and issuance of a debt instrument with 15 years maturity, 3 years grace period, and at an interest rate equal to the central bank's policy rate. With respect to government debt owed to ARO and SPAT, the Treasury has issued special Treasury bonds to settle these obligations.

15. **Overall, the 2014 supplementary budget aims at an overall budget deficit (commitment basis) of 2.1 percent of GDP.** Revenues would amount to 11.1 percent of GDP, current spending would amount to 10.8 percent of GDP, and capital spending would amount to 6.1 percent of GDP. Bank financing of the fiscal deficit would be kept to no more than 1.3 percent of GDP.

16. **As part of the longer-term objective of addressing Madagascar's public finances and ensuring their sustainability, the government will also focus efforts on improving public financial management (PFM).** In line with the findings of the 2013 Public Expenditure and Financial Accountability (PEFA) assessment and the recent PFM diagnostic mission from the Fund, the government will take actions in several areas:

- Improving transparency, accountability and governance of public finances. An action plan to finalize the settlement laws for fiscal years 2008–13 in accordance with the legal timeline will be prepared by July 2014. There will be a strengthening of capacity and resources at key governance institutions (General Inspection of the State, General Directorate of Financial Control, Inspection of the Treasury, and BIANCO) and broadening of their authority to ensure accountability. In addition, the setting up of the Council for Budgetary and Financial Discipline will be effective by October 2014 and the High Court of Justice will be operational within the next 12 months.

- Improving budget execution monitoring and control, through modernization of the information management system in order to better track spending through the cycle, strengthen embedded internal control devices and fasten the production of financial statements.

- Formulating a medium-term strategy to modernize the PFM system with the support of our development partners.

17. **The government has announced the return to market-determined prices of fuel products at the pump.** The current fuel-price subsidy is very costly (1.5 percent of GDP per year) and is not well targeted. Consequently, starting July 1, 2014, gradual increases of the prices will be undertaken every three months by an amount of at least MGA 100 (one hundred MGA), adjustable depending on the circumstances until government subsidies are no longer necessary. At that point, the minimum price will be determined by the OMH automatic pricing mechanism. This process

should take no longer than 12 months from the effective implementation of the supporting measures elaborated in paragraph 18. Studies show that the inflationary impact of this measure would be relatively modest and short-lived. As part of this process, it has been agreed with the petroleum companies to increase the quality of diesel to international ultra-low-sulfur standards of 50 ppm.

18. **Conscious of the social implications resulting from the fuel subsidy removal, the government will put in place mitigating policies, with the support of our development partners, to include:**

- Targeted subsidies for public transport in urban areas. These subsidies, of a temporary nature, will help moderate the pass through of fuel price increases to urban transport fares. This program will be put in place in the context of the 2014 supplementary budget.
- An expansion of the "cash-for-work" program in rural areas.
- An extension of the pilot program of cash transfers conditional on school participation.
- An expansion of the school-kits program to a larger number of regions.

Information campaigns on these supporting measures have been planned.

19. **It is essential to scale up infrastructure spending over the medium term, while preserving debt sustainability**. A medium-term investment and debt management strategy will be prepared to ensure that public and external borrowing remains within limits that maintain debt sustainability. As such, external public sector borrowing that is undertaken will be limited to concessional sources. That said, if all possibilities for concessional external financing are exhausted, Fund and World Bank staff will be consulted in advance to consider the option of non-concessional borrowing to meet critical infrastructure needs. As part of the reinforced dialogue with development partners, a donor conference to discuss medium-term priorities is planned for the last quarter of 2014. A private-public partnership (PPP) framework will also be prepared.

20. **Monetary policy will aim to maintain single-digit inflation.** To this end, the Central Bank is committed to maintain a prudent monetary stance anchored on the agreed indicative targets on net domestic assets and net foreign assets for the remainder of the year. The Central Bank will begin to rebuild its reserve cover, while letting the official exchange rate be determined by market conditions. By end–2014, the foreign exchange reserve stock will amount to at least SDR 529 million (2.3 months of import cover). The monetary authorities will not engage in activities or take measures that could introduce or intensify exchange and trade restrictions.

21. **An inclusive financial sector and financial deepening will require comprehensive reforms.** Against this background, the reform agenda will comprise: (i) the establishment of a framework for the development of the financial market; (ii) central bank internal audit and control functions; and (iii) banking system supervision and financial regulation. The legal framework will be reviewed to ensure that it incorporates best international practice in the area of anti-money

laundering and combating financing of terrorism, which in turn would complement anti-corruption efforts. Madagascar will join the regional institution Eastern and Southern African Anti-Money Laundering Group (ESSAMLG) and will pursue a prompt consideration by the National Assembly of the Law on Combating the Financing of Terrorism. The Central Bank is committed to continue addressing weaknesses identified by the last safeguards assessment, including making the Central Bank accounting framework compliant with IFRS norms, and would welcome an updated assessment in the near future. Following Parliamentary approval by the National Assembly, the Central Bank will continue the publication of the annual audited financial statements. Technical assistance from the IMF and other development partners will be important for progress in these areas.

Other issues

22. **Structural reforms are essential to bring the Malagasy economy back on the path of sustainable and inclusive growth.** In particular, this involves reforms advancing good governance and the rule of law, creating a level playing field for the private sector, and encouraging foreign investment. In this context, the government is preparing a new poverty reduction and growth strategy (PRS) to be completed in October 2014. On this basis, we would aim to present a macroeconomic program and an agenda of structural reforms that could be supported by an IMF arrangement under the Extended Credit Facility.

23. **The government will elaborate a plan to revitalize the public utility company JIRAMA.** Short-term measures include management and operations reforms, in particular to eradicate theft. In the medium term, the government envisages to take measures to control the price and volume of fuel products and to reduce the amount of electricity losses. It will also address issues related to electricity tariffs, increase in operational efficiency, and compliance by JIRAMA with the provisions of the law on commercial companies.

24. **Close engagement with development partners is essential.** The Malagasy Government looks forward to a further strengthening of the ongoing collaboration on key issues aimed at addressing the challenges of Madagascar. The Malagasy Government seizes this opportunity to encourage development partners to move quickly and provide essential concessional financing, ideally in the form of budget support.

Table 1. Madagascar: Indicative Targets 2014[1]

	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(Billions of Ariary; unless otherwise indicated)		
External			
Ceiling on accumulation of new external payment arrears (millions of SDRs)[2]	0	0	0
Central bank			
Floor on net foreign assets (NFA) of BCM (millions of SDRs)	0	18	40
Ceiling on net domestic assets (NDA) of BCM	41	119	130
Fiscal			
Ceiling on net bank credit to central government (ceiling)	106	210	348
Floor on tax revenue	1,114	1,707	2,834
Floor on social priority spending	65	108	215
Memorandum items			
External budget support (millions of SDRs)	0	38	120
Capitalization of BCM losses as a result foreign exchange subsidies	113	113	113

Sources: Madagascar authorities; and IMF staff projections.

[1]Cumulative figures from the beginning of the year.

[2]This target will be monitored on a continuous basis starting from end-May, 2014.

Attachment II. Technical Memorandum of Understanding on Monitoring Indicative Targets

1. This technical memorandum of understanding (TMU) defines the variables used to establish the indicative targets for 2014, how they are calculated, and any adjustments that may be necessary. Unless otherwise indicated, flow variables are measured as cumulative from the beginning of the calendar year.

2. The definition of the central government (CG) corresponds to the scope of operations of the treasury, as shown in the *opérations globales du Trésor* (or OGT).

A. Ceiling on External Payments Arrears

3. These arrears consist of overdue debt-service obligations (i.e., payments of principal and interest) related to loans contracted or guaranteed by the government or the Central Bank of Madagascar (BCM). Debt service obligations (including unpaid penalties and interest charges) are overdue if they have not been paid by the due date or within a grace period agreed with, or unilaterally granted by, each creditor before the due date. They exclude arrears resulting from nonpayment of debt service for which rescheduling negotiations are under way or that are in dispute. This indicative target should be observed on a continuous basis.

B. Non-concessional External Borrowing

4. If the CG has a special need for external non-concessional financing, consultations with IMF staff should take place well in advance of signing of a loan contract or loan guarantee.

Definition

5. Non-concessional external debt has a grant element of less than 35 percent.
The commitment to consult with IMF staff applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (IMF Executive Board Decision No. 12274–00/85, August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Non-concessional debt includes financial leasing and any other instrument giving rights to a current financial liability, under a contract or guarantee by the CG of Madagascar (defined in paragraph 2), but it excludes debt contracted under rescheduling agreements and normal import-related credits of less than one year.

Calculation

6. Calculation of the degree of concessionality of new external borrowing is based on a 5 percent discount rate.

C. Floor for Net Foreign Assets of the Central Bank of Madagascar

Definition

7. The net foreign assets (NFA) of the Central Bank of Madagascar (BCM) are defined as the difference between its gross foreign assets and total foreign liabilities, including debt to the IMF.

Calculation

8. The change in NFA will be measured in SDRs. Assets and liabilities denominated in other currencies than SDRs are converted to SDRs at the exchange rate prevailing at the time of outcome. If budget support (external grants and loans) falls short of projections, the indicative target for NFA will be adjusted downward by the difference, for up to SDR 60 million.

D. Ceiling on Net Domestic Assets of the Central Bank of Madagascar

Definition

9. The net domestic assets (NDA) of the BCM are defined as the difference between reserve money and the NFA of the BCM measured in MGA. It includes net credit to the government, credit to enterprises and individuals, claims on banks, liabilities to banks (including the proceeds of BCM deposit auctions—*appels d'offres négatifs,* and open market operations), and other items net.

Calculation

10. When calculating NDA, NFA is converted to MGA at the fixed exchange rate of:

1 SDR = 3,455.1 MGA.

E. Ceiling on Net Bank Claims on the Central Government (CG)

Definition

11. Net bank claims on the CG are measured by net credit to government in the monetary survey, which consists of BCM and commercial bank claims on the CG, including auctioned treasury bills (BTAs) and other securities and liabilities, net of CG deposits with the BCM and commercial banks, including foreign currency deposits.

Calculation

12. The ceiling on Net Bank Claims on the CG will be adjusted downward by any shortfall in capitalization of Central Bank of Madagascar foreign exchange losses due to petroleum price subsidies.

F. Floor on Tax Revenue

Definition

13. Tax revenue includes all domestic taxes and taxes on foreign trade received by the CG treasury.

G. Floor on Priority Social Spending

Definition

14. Priority social spending includes spending primarily related to interventions in nutrition, education, health, and the provision of social safety nets.

Calculation

15. Priority social spending is calculated as the sum of spending defined above related to (i) the Presidency; (ii) the Prime Minister's Office; (iii) the Ministry of Finance and Budget; (iv) the Ministry of Health; (v) the Ministry of Population and Social Affairs; and (vi) the Ministry of National Education. (See table 2).

H. External Budget Support

Definition

16. External budget support is defined as cash budget loans and grants (i.e., not linked to projects) that are provided as financing and result in funds available to the treasury.

Calculation

17. External budget support is converted to SDRs at the exchange rate prevailing at the time when the transaction takes place.

Table 2. Madagascar: Social Spending in 2014 by Ministry
(Billions of Ariary)

01. Présidence (Presidency)	**10.6**
031. Coordination de la lutte contre le sida	
068. Appui au développement des localités cibles	
069. Renforcement de la sécurité présidentielle	
071. Renforcement de la lutte contre le blanchiment de capitaux	
070. Service civique au service développement humain et durable	
05. Primature (Prime Minister's Office)	**1.5**
066. Cellule de prévention et gestion des urgences (CPGU)	
095. Projet d'urgence de sécurité alimentaire et de reconstruction	
21. Ministère des Finances et du Budget (Ministry of Finance and Budget)	**85.4**
189. Appui d'urgence aux services essentiels d'education, de santé et de nutrition	
190. Projet d'urgence pour la préservation des infrastructures et la réduction de la vulnérabilité	
192. Projet UE - gouvernance - finances publiques	
193. Appui aux couches défavorisées	
194. HIMO - Développement	
71. Ministère de la Santé (Ministry of Health)	**22.0**
022. Appui à la politique de survie de la mère et de l'enfant (ex bien être de la famille)	
024. Appui au système hospitalier de référence	
025. Appui aux programmes de lutte contre les maladies transmissibles	
026. Appui aux districts sanitaires	
028. Equipes sanitaires mobiles	
041. Projet de développement d'un système de santé pérenne (swaps)	
044. Utilisation accrue sces et produits de santé sélectionnés (ex appropop)	
045. Appui aux programmes de lutte contre les maladies non transmissibles	
046. Appui aux programmes de lutte contre les maladies epidemo-endémiques	
76. Ministère de la Population et des Affaires Sociales (Ministry of Population and Social Affairs)	**2.0**
031. Droits et protection des enfants (ex: services urbains de base)	
032. Appui au regroupement communautaire	
040. Appui aux ménages en difficulté	
043. Appui à la promotion de la participation des ONG dans les projets sociaux	
046. Amélioration de la condition de vie des personnes agées	
056. Appui aux services sociaux de base	
066. Fonds social de développement VIII	
81. Ministère de l'Education Nationale (Ministry of National Education)	**93.9**
104. Appui à l'enseignement primaire en matière de nutrition	
105. Redynamisation de l'enseignement primaire	
107. Education pour tous (volet MINESEB)	
110. Appui aux écoles endommagées par les cyclones	
130. Construction/rehabilitation des bâtiments administratifs	
131. Appui à l'intégration des tics	
135. Amélioration de la qualité de l'éducation à Madagascar (AQUEM)	
138. Programme d'appui aux services sociaux de base - éducation (PASSOBA)	
136. Projet d'appui d'urgence à l'éducation pour tous (PAUEPT)	
Total	**215.4**

Source: Malagasy authorities.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS

June 3, 2014

Approved By
David Robinson and Chris Lane (IMF) Jeffrey D. Lewis and Marcelo Giugale (IDA)

Prepared by the International Monetary Fund and the International Development Association

Using the joint IMF-World Bank debt sustainability framework for low income countries, the debt sustainability analysis (DSA) assesses Madagascar's risk of external debt distress to be 'low'. This is unchanged from the last DSA carried out in 2008. The public DSA suggests that Madagascar's total public and publically guaranteed (PPG) debt dynamics are sustainable, although weak fiscal revenue generation is a source of vulnerability. The authorities agreed with the assessment.

Risk of external debt distress:	**Low**
Augmented by significant risks stemming from domestic public and/or private external debt?	**No**

INTRODUCTION

1. **This DSA has been prepared jointly by IMF and World Bank staff.** It is based on the framework for low-income countries approved by the respective Executive Boards. The framework takes into account indicative thresholds for debt burden indicators determined by the quality of the country's policies and institutions[1]. The assessment comprises a baseline scenario and a set of alternative scenarios.

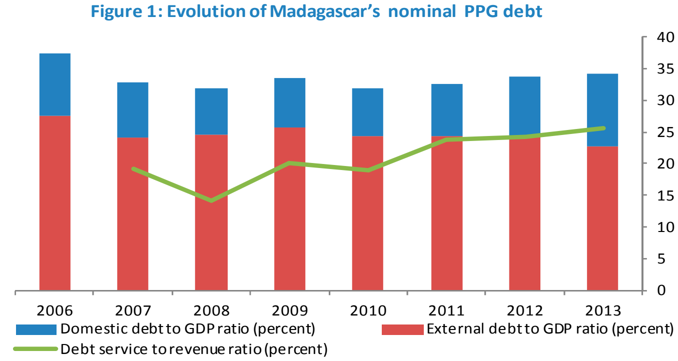
RECENT DEVELOPMENTS AND CURRENT DEBT SITUATION

2. **Since HIPC Completion in 2006, Madagascar's external PPG debt as a proportion of GDP has been on a modest downward trend.** At end-2013, PPG nominal external debt was 23 percent of GDP, below Madagascar's post-HIPC average of 25 percent (Figure 1). This was partly as a result of reduced donor inflows during the crisis period. Around 80 percent of external debt is owed to multilateral creditors, mainly the World Bank.

3. **Domestic PPG debt has risen since 2008**, partly to compensate for fewer external financing opportunities. In 2008, domestic debt was 7 percent of GDP, which increased to 11 percent by end-2013 (Table 1). This debt includes domestic budgetary arrears, which increased sharply in 2013.

4. **Overall, the debt strategy of the authorities has been prudent over the crisis.** Total PPG debt was stable around 33 percent of GDP throughout the transition, and the authorities refrained from borrowing externally on non-concessional terms. However, the debt service to revenue ratio has increased due to a greater reliance on domestic financing and declining fiscal revenues (Figure 1).

Figure 1: Evolution of Madagascar's nominal PPG debt



Sources: Malagasy authorities and IMF staff estimates.

5. **This DSA includes public debt and guarantees of the *general* government.** Local governments do not formally issue debt liabilities, but may have arrears to domestic counterparties, for which data are not available. The measure of debt is on a *gross* rather than *net* basis.

[1] According to the World Bank Country and Policy Institutional Assessment (CPIA) Index, Madagascar is rated as a 'low' performer, a downgrade since the last DSA in 2008. The indicative thresholds for external debt applicable for that category of countries are: (i) 30 percent for the PV of debt-to-GDP ratio; (ii) 100 percent for PV of debt-to-exports ratio; (iii) 200 percent for the PV of debt to fiscal revenues ratio; (iv) 15 percent for the debt service to exports ratio; and (v) 18 percent for the debt service to revenue ratio. The indicative threshold for the PV of total PPG debt is 38 percent of GDP.

Table 1 Madagascar: Break-Down of Total PPG Debt (End-2013)

Creditor	Amount (US$m)	Percent of GDP	Percent of total
Domestic debt, of which:	**1,214**	**11.4**	**33.3**
Bonds	513	4.8	14.1
Other inc arrears	701	6.6	19.2
External debt, of which:	**2,427**	**22.8**	**66.7**
Multilateral	1,884	17.7	51.7
Paris Club	108	1.0	3.0
Non-Paris Club	416	3.9	11.4
Commercial	18	0.2	0.5
Total PPG debt	**3,641**	**34.2**	**100.0**

6. **Private external debt is mainly issued by subsidiaries of multinational companies.** According to the authorities, external debt owed by *domestically* owned companies and households is negligible (around US$15 million). There are, however, a number of multinational companies— for instance in the mining, banking, telecommunication sector—whose wholly owned local subsidiaries have issued external debt. The authorities do not have comprehensive data on these obligations. But by far the largest of these debtors is the Nickel/Cobalt mine and processing facility near Antananarivo, where, reflecting the financial structure of the initial capital investment in the project, the local subsidiary has external debt of around US$2 billion (20 percent of GDP). This obligation accounts for the bulk of the increase in total external debt from 24 percent of GDP in 2007 to 44 percent at end-2013. This commercial loan is scheduled to be fully repaid by 2030.

UNDERLYING ASSUMPTIONS

7. **The key variables driving the debt dynamics are forecast to improve over the coming years, but remain more conservative than the medium-term projections in the 2008 DSA (Box 1).** The strengthening economic recovery forecast in the macroeconomic framework will provide space for the authorities to invest in much needed infrastructure. Much of this investment will be financed through concessional external borrowing and grants, although the latter will decline over the longer-term. The average grant element of new borrowing is projected to decline from 50 percent today to around 35 percent in 2034.

Box 1: Baseline Macroeconomic Assumptions

Real GDP growth. Growth is expected to recover to around 4.5 percent over the medium term, compared to an average of 3.2 percent over the last decade (which includes the crisis years). This is driven by improved confidence, a re-engagement of development partners, and increased mining exports.

Inflation and interest rates. Inflation as measured by the GDP deflator in US dollar terms is likely to stay low and stable, averaging around 2 percent. The highly concessional terms of the external PPG debt implies a real effective interest rate of around -0.8 percent over 2014–19. This gradually increases as the degree of concessionality is assumed to decline.

Current account. Mining exports are expected to gradually increase as the two major projects reach full production capacity. This will be accompanied by a bounce back in imports, as domestic consumption and investment recover. These two factors are projected to largely offset each other, leading to a relatively stable non-interest current account of around 3.5 percent of GDP.

Tax revenues. This is an area of vulnerability for debt sustainability. Fiscal revenues have fallen from (a relatively modest) 11.8 percent of GDP in 2008, to 9.3 in 2013. The DSA assumes the authorities will be able to reach 2008 levels by around 2017–18; rising further to over 15.5 percent by 2034.

Grants. Donor support is projected to rapidly increase in 2014 to around pre-crisis levels, and then stabilize over the medium term. Over the long-run, grants are assumed to decline to zero by 2034.

Total expenditure. Government spending will initially fall with the removal of the fuel subsidy over the next 12 months but then gradually increase as the government raises social and infrastructure spending.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

A. Baseline Scenario

8. **The level of PPG external debt, which is currently a little over US$2.4 billion, is projected to gradually grow throughout the forecast horizon.** It is forecast to increase from 23 percent of GDP in 2013 to 30 percent by 2034, as the government supports much needed infrastructure investment and social spending. A persistent trade deficit and outflows from the mining sector[2] are balanced with increasing grant inflows (over the next decade) and relatively strong growth. FDI inflows are assumed to be lower than that experienced over the last few years, during which major mining projects were being constructed. As the Malagasy economy develops, non-concessional borrowing is projected to increase, especially after 2020 (Table 3).

[2] The large residual in Table 4 is partly related to mining activity. Mining exports are recorded in full in the balance of payment statistics. However, only a fraction of these receipts actually return to Madagascar, with the remainder being repatriated to the parent companies. Another contribution to the residual relates to discrepancies in the authorities' debt database between the sum of amortizing debt and the debt stock.

Table 2. Madagascar: Baseline Macroeconomic Assumptions

	2014	2015	2016	2017	2018	2008 DSA*
Real GDP growth (percent)	3.0	4.0	4.5	4.5	4.5	6.2
GDP deflator in US$ terms (percent)	2.0	2.0	2.5	2.2	2.0	3.0
Non-interest current account (percent GDP)	-3.1	-5.4	-5.2	-5.0	-4.3	-5.3
Total revenues (percent of GDP)	11.1	11.3	12.3	12.0	12.3	14.1
Grants (percent of GDP)	3.7	3.7	3.7	3.7	3.7	4.1
Expenditure inc. interest (percent of GDP)	17.3	17.2	17.5	17.8	18.2	21.0

*Projected medium-term values in the 2008 DSA.

Source: IMF staff projections.

Table 3. Madagascar: Projected Disbursements of PPG External Debt

	2014	2015	2014–19 Average	2020–34 Average
Concessional (Millions of US$)	280	304	338	684
Percent of GDP	*2.5*	*2.6*	*2.6*	*2.6*
Non-concessional (Millions of US$)	0	0	3.71	123
Percent of GDP	*0*	*0*	*0.0*	*0.4*
Total (Millions of US$)	280	304	341	807
Percent of GDP	*2.5*	*2.6*	*2.6*	*3.0*

Sources: Mlalagasy authorities and IMF staff projections.

9. **Under the baseline projection, all PPG external debt indicators remain below the policy-dependent debt burden thresholds** (Figure 2). The present value (PV) of the current level of PPG external debt, 11.9 percent of GDP, is projected to increase to 17.6 percent by 2034. This projection is broadly consistent with the medium term forecast from the last DSA conducted in 2008.

10. **Private external debt is projected to slowly decline, as the mining project loans are repaid.** Given the exceptional nature of this project, the DSA does not forecast substantial new external borrowing from the private sector. As the ultimate liability of the existing loans is to the multinational shareholders, rather than resident entities (such as domestic banks or the government), these do not constitute a threat to external sustainability.

B. Alternative Scenarios

11. Three alternative scenarios are constructed to stress-test the baseline external PPG debt projection. First, the standard bounds tests, which apply pre-defined shocks to the key macroeconomic variables that drive external debt[3]. Second, a historical scenario where macroeconomic variables are assumed to equal their average over 2004–13. Third, a customized scenario, focused on non-concessional borrowing. These shocks are illustrated in Figure 2 and Table 5.

12. None of the standard bounds tests cause a breach of the thresholds for PPG external debt. The historical scenario[4] projects a rapid increase in all debt metrics, and causes a breach for four of the five external debt thresholds. But there are two reasons to put less weight on this scenario. First, the very large current account deficit in 2008 and 2009 (over 20 percent of GDP in both years) was mainly driven by substantial imports associated with large mining investments, which were partly financed through non-debt creating FDI. Second, the historical averages are calculated over a period of crisis in Madagascar, where key variables such as growth are unlikely to persist at such levels for a long period of time.

13. The third scenario is based on a customized set-up. It assumes that, on top of the baseline projections, the authorities contract a US$400 million non-concessional loan, disbursed over 2014–16. While this expanded baseline does not lead to breaches of any threshold as shown in Figure 2, it could lead to a deterioration in the risk of debt distress as stress tests may push debt indicators above relevant thresholds. The authorities need to remain vigilant on debt sustainability pressures if they embark on contracting non-concessional borrowing.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

A. Baseline Scenario

14. Domestic PPG debt as a proportion of GDP is projected to decline over the next decade, with the authorities substituting away from local financing into concessional borrowing, as donor relations normalize, and with the clearance of domestic arrears. Domestic PPG debt is expected to grow as a proportion of GDP over the long-term, as domestic markets deepen.

15. The *present value* of total PPG debt is projected to increase from 23 percent of GDP at present to 25 percent by 2034 - well below the threshold (Table 7). Madagascar's relatively weak revenue to GDP ratio, leaves the authorities somewhat vulnerable on the debt service to revenue measure, which is likely to increase through time as higher interest payments (associated with less concessional financing) increase at a faster rate than revenue mobilization.

[3] Summarized in footnote 1 of Figure 2.

[4] Key macroeconomic variables (non-interest current account, growth, GDP deflator, growth of exports, current official transfers and net FDI) remain fixed at the average of the 2004–13 period.

B. Alternative Scenarios

16. Of the three alternative scenarios used to stress-test the baseline, one causes a breach of the threshold in 2032 (Figure 3). This breach is the scenario whereby the primary deficit as a proportion of GDP remains unchanged throughout the forecast, generating the highest debt to GDP ratio trajectory. However, staff and authorities agree that reducing the current gap between revenue and spending is a priority, thus this scenario is not viewed as sufficient to motivate a change in the overall debt sustainability risk rating.

CONCLUSIONS

17. The authorities agree with the overall assessment that the risk of external distress is low. And also that the risks from private external debt and public domestic debt do not justify a change in the overall debt sustainability assessment. The authorities plan to use this DSA to help develop their medium-term debt strategy. Furthermore, they hope that the upcoming World Bank funded DSA training will help strengthen their capacity to take greater ownership of this analysis themselves. Staff and the authorities will also seek to gather more data and gain a deeper understanding of Madagascar's private external debt stock.

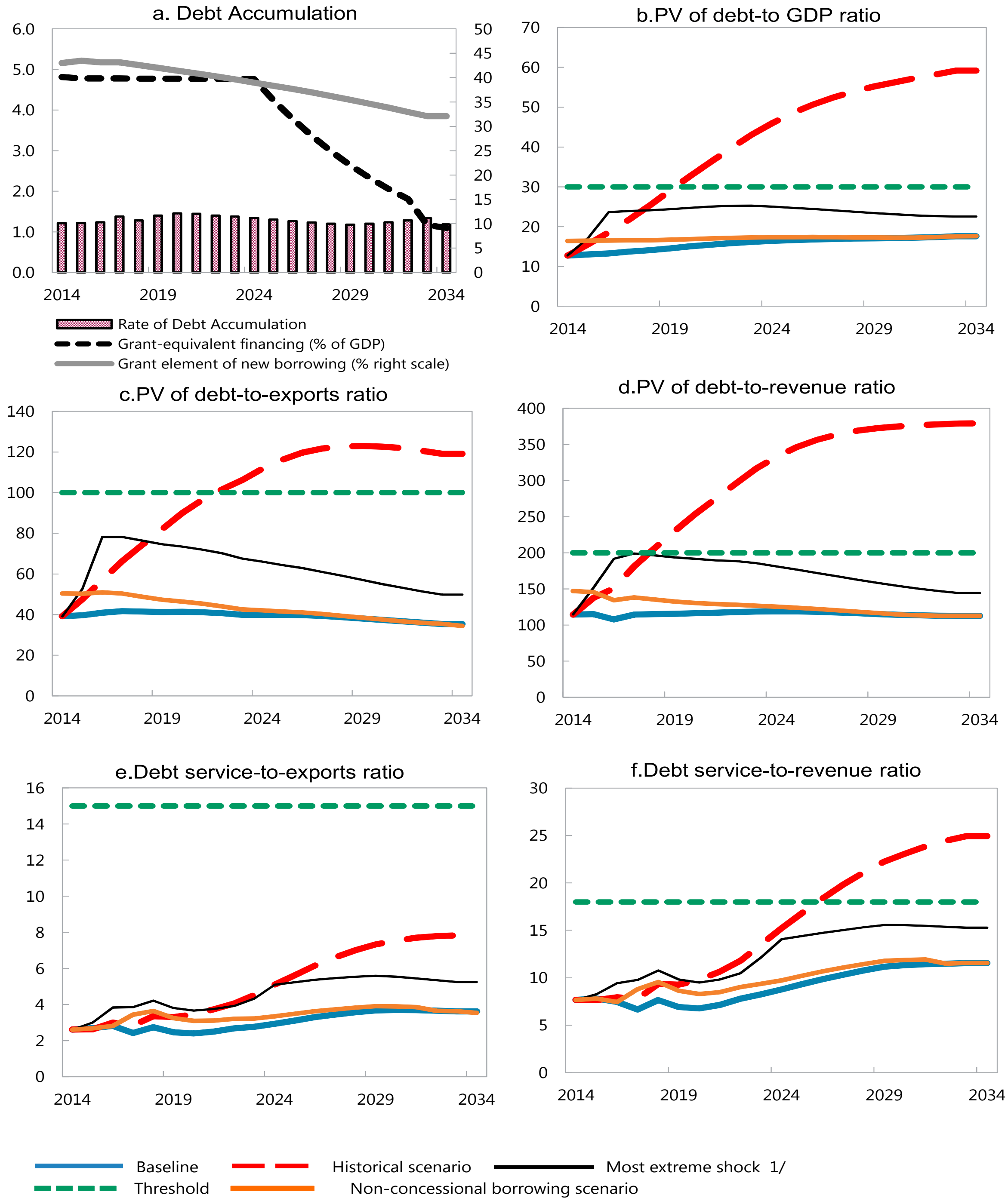
Table 4. Madagascar: External Debt Sustainability Framework, Baseline Scenario, 2008-2034 1/

	Actual						Historical Average 6/	Standard Deviation 6/	Projections									
	2008	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2034	2020-2034 Average
External debt (nominal) 1/	**29.5**	**35.9**	**39.4**	**42.4**	**45.1**	**43.7**	**36.0**	**19.8**	**42.9**	**40.9**	**38.9**	**37.5**	**36.6**	**35.8**	**38.8**	**33.3**	**35.8**	**33.6**
of which: public and publicly guaranteed (PPG)	24.5	25.7	24.4	24.3	24.3	22.8	24.7	23.3	24.1	24.3	24.7	25.1	25.6	26.2	25.0	28.5	30.2	29.0
Change in external debt	5.4	6.4	3.5	3.1	2.7	-1.4	-4.0	16.1	-0.8	-2.1	-1.9	-1.4	-1.0	-0.7	-1.3	-0.4	0.9	0.0
Identified net debt-creating flows	8.4	16.0	5.1	-5.5	-1.2	-3.0			-3.3	-1.0	-1.3	-1.6	-2.0	-2.4		-3.0	-2.3	
Non-interest current account deficit	**20.6**	**21.2**	**7.8**	**6.6**	**6.5**	**5.1**	**9.4**	**6.5**	**3.1**	**5.4**	**5.2**	**5.0**	**4.3**	**3.9**	**4.5**	**3.7**	**4.3**	**4.1**
Deficit in balance of goods and services	24.4	23.7	13.4	11.3	9.6	8.2	14.9	5.4	6.3	6.9	7.3	7.6	7.3	7.0	7.1	7.7	7.9	8.0
Exports	26.6	22.4	24.1	26.9	29.3	30.3			32.6	32.8	32.5	32.9	34.0	35.3		41.1	51.2	43.5
Imports	50.9	46.1	37.6	38.2	38.9	38.5			38.9	39.7	39.8	40.5	41.3	42.3		48.9	59.1	51.5
Net current transfers (negative = inflow)	-4.3	-3.6	-5.0	-6.0	-6.1	-6.0	-6.9	3.3	-7.5	-7.4	-7.4	-7.4	-7.4	-7.4	-7.4	-7.4	-6.5	-7.1
of which: official	-3.6	-0.9	-0.9	-1.5	-1.2	-1.3	-1.9	1.8	-3.7	-3.7	-3.7	-3.7	-3.7	-3.7	-3.7	-3.7	0.0	-2.2
Other current account flows (negative = net inflow)	0.5	1.1	-0.6	1.3	3.0	2.9	1.5	1.1	4.3	5.9	5.3	4.8	4.4	4.3	4.8	3.4	3.0	3.2
Net FDI (negative = inflow)	**-6.9**	**-8.2**	**-4.0**	**-7.8**	**-7.9**	**-5.2**	**-5.2**	**2.5**	**-5.4**	**-5.1**	**-5.1**	**-5.1**	**-5.1**	**-5.1**	**-5.1**	**-5.1**	**-5.1**	**-5.1**
Endogenous debt dynamics 2/	**-5.3**	**3.0**	**1.2**	**-4.3**	**0.2**	**-3.0**	**-1.1**	**9.0**	**-1.1**	**-1.4**	**-1.4**	**-1.4**	**-1.2**	**-1.2**	**-1.3**	**-1.6**	**-1.6**	**-1.6**
Contribution from nominal interest rate	0.0	0.0	1.9	0.3	0.3	0.3	0.3	0.6	0.2	0.3	0.3	0.2	0.4	0.4	0.3	0.5	0.6	0.5
Contribution from real GDP growth	-1.4	1.1	0.0	-0.5	-1.1	-1.0	-1.7	2.0	-1.3	-1.6	-1.7	-1.6	-1.6	-1.6	-1.6	-1.4	0.0	-1.3
Contribution from price and exchange rate changes	-3.9	1.8	-0.6	-4.1	0.9	-2.3			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-3.0**	**-9.5**	**-1.7**	**8.6**	**3.9**	**1.6**	**-7.2**	**15.4**	**2.5**	**-1.1**	**-0.6**	**0.1**	**1.0**	**1.7**	**0.6**	**2.6**	**3.2**	**2.5**
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	...	...	...	32.8			31.6	29.5	27.6	26.2	25.0	24.2		21.2	23.2	
In percent of exports	...	...	...	...	...	108.3			96.9	90.1	84.8	79.5	73.6	68.5		51.6	45.4	
PV of PPG external debt	**...**	**...**	**...**	**...**	**...**	**11.9**			**12.8**	**13.0**	**13.3**	**13.7**	**14.1**	**14.6**		**16.4**	**17.6**	
In percent of exports	**...**	**...**	**...**	**...**	**...**	**39.2**			**39.2**	**39.7**	**40.9**	**41.8**	**41.5**	**41.2**		**39.9**	**34.4**	
In percent of government revenues	**...**	**...**	**...**	**...**	**...**	**124**			**115**	**115**	**108**	**115**	**115**	**116**		**119**	**113**	
Debt service-to-exports ratio (in percent)	**0.6**	**2.0**	**9.0**	**2.3**	**2.0**	**1.7**			**2.6**	**2.7**	**2.8**	**2.4**	**2.8**	**2.5**		**2.9**	**3.5**	
PPG debt service-to-exports ratio (in percent)	**0.6**	**2.0**	**2.3**	**2.3**	**2.0**	**1.7**			**2.6**	**2.7**	**2.8**	**2.4**	**2.8**	**2.5**		**2.9**	**3.5**	
PPG debt service-to-revenue ratio (in percent)	**1.4**	**4.5**	**5.0**	**6.3**	**6.2**	**5.5**			**7.7**	**7.8**	**7.4**	**6.7**	**7.6**	**6.9**		**8.8**	**11.6**	
Non-interest current account deficit that stabilizes debt ratio	15.2	14.7	4.4	3.6	3.8	6.5			3.9	7.5	7.1	6.4	5.2	4.6		4.2	3.5	
Key macroeconomic assumptions																		
Real GDP growth (in percent)	7.2	-3.5	0.1	1.5	2.5	2.4	3.2	3.3	3.0	4.0	4.5	4.5	4.5	4.5	4.2	4.5	4.5	4.5
GDP deflator in US dollar terms (change in percent)	19.6	-5.8	1.7	11.5	-2.2	5.3	4.5	13.9	2.0	2.0	2.5	2.2	2.0	2.0	2.1	2.0	2.0	2.0
Effective interest rate (percent) 5/	0.0	0.0	5.3	0.8	0.7	0.6	0.7	1.6	0.5	0.6	0.7	0.5	1.2	1.0	0.8	1.5	1.7	1.6
Growth of exports of G&S (US dollar terms, in percent)	11.7	-23.5	9.8	25.9	9.4	11.4	11.3	16.4	13.1	6.3	6.3	8.1	10.2	10.8	9.1	8.2	10.0	9.3
Growth of imports of G&S (US dollar terms, in percent)	40.4	-17.9	-16.9	14.9	2.1	6.6	10.5	21.3	6.3	7.8	7.5	8.6	8.9	9.2	8.0	9.1	9.0	9.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	43.0	43.5	43.1	43.1	42.6	42.0	42.9	39.0	32.1	36.8
Government revenues (excluding grants, in percent of GDP)	12.1	9.9	11.3	9.8	9.7	9.6	10.8	1.0	11.1	11.3	12.3	12.0	12.3	12.6	11.9	13.8	15.7	14.4
Aid flows (in Millions of US dollars) 7/	321.0	141.8	169.6	193	120	134			583	615	659	704	751	801		1105	623	
of which: Grants	321.0	141.8	169.6	193	120	134			418	433	464	496	529	564		778	40	
of which: Concessional loans	0.0	0.0	0.0	0.0	0.0	0.0			165.0	182.1	195.1	208.5	222.3	237.1		326.9	583.5	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...	...	...	...			4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	1.1	3.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...	...	...	...			77.1	76.7	76.5	76.5	76.1	75.7	76.4	73.5	34.2	60.6
Memorandum items:																		
Nominal GDP (Millions of US dollars)	9413.0	8550.4	8705.0	9854	9881	10645			11188	11824	12669	13537	14431	15392		21228	40413	
Nominal dollar GDP growth	28.2	-9.2	1.8	13.2	0.3	7.7			5.1	5.7	7.1	6.8	6.6	6.7	6.3	6.7	6.7	6.6
PV of PPG external debt (in Millions of US dollars)						1247.9			1377.1	1513.6	1659.6	1833.9	2007.1	2209.2		3438.7	7015.7	
(PVt-PVt-1)/GDPt-1 (in percent)									1.2	1.2	1.2	1.4	1.3	1.4	1.3	1.3	1.2	1.3
Gross workers' remittances (Millions of US dollars)	...	...	...	...	...	...			...	...	...	...	...	...		...	...	
PV of PPG external debt (in percent of GDP + remittances)				...	...	11.9			12.8	13.0	13.3	13.7	14.1	14.6		16.4	17.6	
PV of PPG external debt (in percent of exports + remittances)				...	...	39.2			39.2	39.7	40.9	41.8	41.5	41.2		39.9	34.4	
Debt service of PPG external debt (in percent of exports + remittances)				...	...	1.7			2.6	2.7	2.8	2.4	2.8	2.5		2.9	3.5	

Sources: Country authorities; and 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).

Figure 2. Madagascar: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2014-2034 1/



Sources: Country authorities; and staff estimates and projections.

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

Table 5. Madagascar: Sensitivity Analysis For Key Indicators Of Public and Publicly Guaranteed External Debt, 2014–34

(In Percent)

	Projections																
	2014	2015	2016	2017	2018	2019	**2024**	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
PV of debt-to GDP ratio																	
Baseline	13	13	13	14	14	15	**16**	17	17	17	17	17	17	17	17	18	18
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2014-2034 1/	13	16	19	22	25	29	**46**	49	51	52	54	55	56	57	58	59	60
A2. New public sector loans on less favorable terms in 2014-2034 2	13	13	14	16	17	18	**23**	24	25	26	27	28	28	29	30	31	32
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	13	13	14	14	15	15	**17**	17	17	18	18	18	18	18	18	18	18
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	13	15	20	20	21	21	**22**	21	21	21	21	20	20	20	20	20	19
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	13	14	17	17	18	18	**21**	21	21	21	21	21	21	22	22	22	22
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	13	17	22	22	22	22	**23**	22	22	22	21	21	21	20	20	20	20
B5. Combination of B1-B4 using one-half standard deviation shocks	13	17	24	24	24	24	**25**	25	24	24	24	23	23	23	23	23	22
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	13	18	19	19	20	20	**23**	23	23	24	24	24	24	24	24	24	24
PV of debt-to-exports ratio																	
Baseline	39	40	41	42	41	41	**40**	40	40	39	39	38	37	37	36	35	34
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2014-2034 1/	39	48	57	66	74	82	**112**	116	120	122	123	123	123	122	121	119	117
A2. New public sector loans on less favorable terms in 2014-2034 2	39	41	45	48	49	50	**56**	58	59	60	61	61	62	62	63	63	63
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	39	39	41	41	41	41	**39**	39	39	39	38	38	37	36	35	35	34
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	39	53	78	78	76	75	**66**	64	63	61	59	57	55	53	51	50	48
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	39	39	41	41	41	41	**39**	39	39	39	38	38	37	36	35	35	34
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	39	52	67	66	65	63	**55**	54	52	50	49	47	45	43	42	40	39
B5. Combination of B1-B4 using one-half standard deviation shocks	39	51	68	68	66	65	**57**	55	54	52	51	49	47	45	44	42	41
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	39	39	41	41	41	41	**39**	39	39	39	38	38	37	36	35	35	34
PV of debt-to-revenue ratio																	
Baseline	115	115	108	115	115	116	**119**	119	118	118	117	115	114	114	113	113	113
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2014-2034 1/	115	138	151	182	206	230	**333**	347	357	364	369	373	375	377	378	379	382
A2. New public sector loans on less favorable terms in 2014-2034 2	115	119	118	130	136	141	**168**	172	176	180	183	186	189	193	196	201	204
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	115	117	113	120	120	121	**124**	124	123	122	121	120	119	118	117	117	116
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	115	136	164	171	169	166	**157**	153	149	145	141	137	134	131	128	126	124
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	115	128	136	144	145	145	**149**	149	148	147	146	144	143	142	141	141	140
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	115	152	175	182	179	176	**164**	159	155	150	146	141	138	134	131	128	126
B5. Combination of B1-B4 using one-half standard deviation shocks	115	152	192	199	197	194	**181**	177	172	168	163	158	154	150	147	144	142
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	115	161	151	160	161	162	**166**	166	165	164	162	161	159	158	157	157	156

Table 5. Madagascar: Sensitivity Analysis For Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34 (concluded)

	Projections																
	2014	2015	2016	2017	2018	2019	**2024**	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
							Debt service-to-exports ratio										
Baseline	3	3	3	2	3	2	**3**	3	3	3	4	4	4	4	4	4	4
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2014-2034 1/	3	3	3	3	3	3	**5**	6	6	7	7	7	8	8	8	8	8
A2. New public sector loans on less favorable terms in 2014-2034 2	3	3	3	3	3	3	**3**	3	4	4	4	4	4	4	4	4	4
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	3	3	3	2	3	2	**3**	3	3	3	4	4	4	4	4	4	4
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	3	3	4	4	4	4	**5**	5	5	5	6	6	6	5	5	5	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	3	3	3	2	3	2	**3**	3	3	3	4	4	4	4	4	4	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	3	3	3	3	3	3	**4**	4	4	5	5	5	5	4	4	4	4
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	3	3	4	3	**4**	5	5	5	5	5	5	5	5	4	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	3	3	3	2	3	2	**3**	3	3	3	4	4	4	4	4	4	4
							Debt service-to-revenue ratio										
Baseline	8	8	7	7	8	7	**9**	9	10	10	11	11	11	11	11	12	12
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2014-2034 1/	8	8	8	8	9	9	**15**	17	18	20	21	22	23	24	24	25	25
A2. New public sector loans on less favorable terms in 2014-2034 2	8	8	7	7	8	8	**9**	10	11	11	12	12	13	13	14	14	14
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	8	8	8	7	8	7	**9**	10	10	11	11	12	12	12	12	12	12
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	8	8	8	8	9	8	**12**	12	13	13	13	13	13	13	13	13	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	8	9	9	8	10	9	**11**	12	13	13	14	14	14	15	15	15	15
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	8	8	9	9	10	9	**13**	13	13	14	14	14	14	14	14	14	13
B5. Combination of B1-B4 using one-half standard deviation shocks	8	8	9	10	11	10	**14**	14	15	15	15	16	16	15	15	15	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	8	11	11	9	11	10	**12**	13	14	15	15	16	16	16	16	16	16
Memorandum item:																	
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	30	30	30	30	30	30	**30**	30	30	30	30	30	30	30	30	30	30

Sources: Country authorities; and 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 6. Madagascar: Public Sector Debt Sustainability Framework, Baseline Scenario, 2008–34

(In Percent of GDP, unless otherwise indicated)

	Actual								Projections									
	2008	2009	2010	2011	2012	2013	Average 5/	Standard Deviation 5/	2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
Public sector debt 1/	31.8	33.4	32.0	32.6	33.8	34.2	45.0	24.4	34.5	34.3	34.2	34.0	34.0	33.9	34.1	35.1	37.4	35.8
of which: foreign-currency denominated	24.5	25.7	24.4	24.3	24.3	22.8	35.7	23.3	24.1	24.3	24.7	25.1	25.6	26.2	25.0	28.5	30.2	29.0
Change in public sector debt	-1.0	1.6	-1.5	0.6	1.2	0.4			0.3	-0.2	-0.1	-0.2	-0.1	-0.1		0.4	0.0	
Identified debt-creating flows	...	3.1	0.5	1.2	0.9	3.1			0.8	-0.6	-1.1	-0.3	-0.1	-0.2		0.4	0.3	
Primary deficit	1.6	2.1	0.0	2.0	2.5	5.3	1.8	1.8	1.7	1.4	0.7	1.4	1.3	1.3	1.3	1.8	1.8	1.7
Revenue and grants	15.5	11.5	13.2	11.7	10.9	10.9	14.9	3.9	14.9	15.0	16.0	15.7	15.9	16.3	15.6	17.5	15.8	16.6
of which: grants	3.4	1.7	1.9	2.0	1.2	1.3	4.1	3.2	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	0.1	2.2
Primary (noninterest) expenditure	17.0	13.6	13.2	13.7	13.4	16.2	16.8	3.5	16.6	16.4	16.7	17.1	17.2	17.5	16.9	19.3	17.6	18.3
Automatic debt dynamics	...	1.0	0.5	-0.8	-1.6	-2.2			-0.9	-2.0	-1.8	-1.7	-1.4	-1.5		-1.5	-1.5	
Contribution from interest rate/growth differential	...	1.5	-0.1	-0.5	-0.8	-0.8			-1.3	-1.6	-1.7	-1.6	-1.4	-1.6		-1.6	-1.6	
of which: contribution from average real interest rate	...	0.3	0.0	-0.1	0.0	0.0			-0.3	-0.3	-0.2	-0.2	0.1	-0.1		-0.1	0.0	
of which: contribution from real GDP growth	-2.2	1.2	0.0	-0.5	-0.8	-0.8			-1.0	-1.3	-1.5	-1.5	-1.5	-1.5		-1.5	-1.6	
Contribution from real exchange rate depreciation	...	-0.5	0.6	-0.3	-0.7	-1.3			0.5	-0.4	-0.1	0.0	0.0	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	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	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	0.0		0.0	0.0	
Reduction of domestic arrears	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	...	-1.5	-2.0	-0.6	0.3	-2.7	-1.3	1.2	-0.5	0.5	1.0	0.1	0.0	0.1	0.2	0.0	-0.3	0.0
Other Sustainability Indicators																		
PV of public sector debt	...	...	...	...	...	23.3			23.1	23.0	22.8	22.7	22.4	22.2		23.0	24.8	
of which: foreign-currency denominated	...	...	...	...	...	11.9			12.8	13.0	13.3	13.7	14.1	14.6		16.4	17.6	
of which: external	...	...	...	...	...	11.9			12.8	13.0	13.3	13.7	14.1	14.6		16.4	17.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	7.0	7.6	5.7	7.8	8.6	12.2	16.7	17.3	9.6	8.7	7.8	8.2	7.9	7.4	8.3	7.2	8.2	7.5
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	...	...	...	214.5			155.5	153.5	142.8	144.8	140.9	136.8		131.6	156.7	
PV of public sector debt-to-revenue ratio (in percent)	...	...	...	...	...	242.6			207.7	203.3	185.3	189.0	183.0	176.5		166.6	157.7	
of which: external 3/	...	...	...	...	...	123.8			114.7	115.2	107.9	114.5	115.2	115.5		119.1	112.2	
Debt service-to-revenue and grants ratio (in percent) 4/	11.1	17.2	16.2	19.7	21.4	22.7	56.2	80.4	18.2	17.9	16.6	15.8	16.0	14.5	16.5	14.0	20.0	16.5
Debt service-to-revenue ratio (in percent) 4/	14.2	20.1	19.0	23.7	24.1	25.7	93.0	149.3	24.3	23.8	21.5	20.7	20.8	18.8	21.6	17.7	20.1	18.8
Primary deficit that stabilizes the debt-to-GDP ratio				1.4	1.3	4.9	2.5	2.1	1.4	1.6	0.8	1.6	1.3	1.3	1.3	1.4	1.8	1.4
																	0.0	
Key macroeconomic and fiscal assumptions																	0.0	
Real GDP growth (in percent)	7.2	-3.5	0.1	1.5	2.5	2.4	3.2	3.3	3.0	4.0	4.5	4.5	4.5	4.5	4.2	4.5	4.5	4.5
Average nominal interest rate on forex debt (in percent)	0.0	0.0	1.0	1.3	1.2	1.2	0.5	0.6	1.0	1.1	1.3	0.8	1.8	1.5	1.2	1.8	2.0	1.8
Average real interest rate on domestic debt (in percent)	-0.5	0.3	0.3	1.5	1.0	0.0	1.1	3.3	-1.8	-1.2	0.2	1.2	1.9	1.9	0.4	1.9	1.9	1.9
Real exchange rate depreciation (in percent, + indicates depreciation	...	-1.8	2.3	-1.2	-3.0	-5.7	-1.9	2.9	2.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	9.0	7.8	8.6	8.0	6.0	5.8	9.8	3.8	7.4	7.3	5.7	5.3	5.0	5.0	5.9	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percer	0.0	-0.2	0.0	5.7	-0.2	23.7	2.9	7.5	5.7	2.7	6.5	7.1	5.2	6.5	5.6	6.1	0.9	4.3
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...	...	43.0	43.5	43.1	43.1	42.6	42.0	42.9	39.0	32.1	36.8

Sources: Country authorities; and staff estimates and projections.

1/ General government gross debt

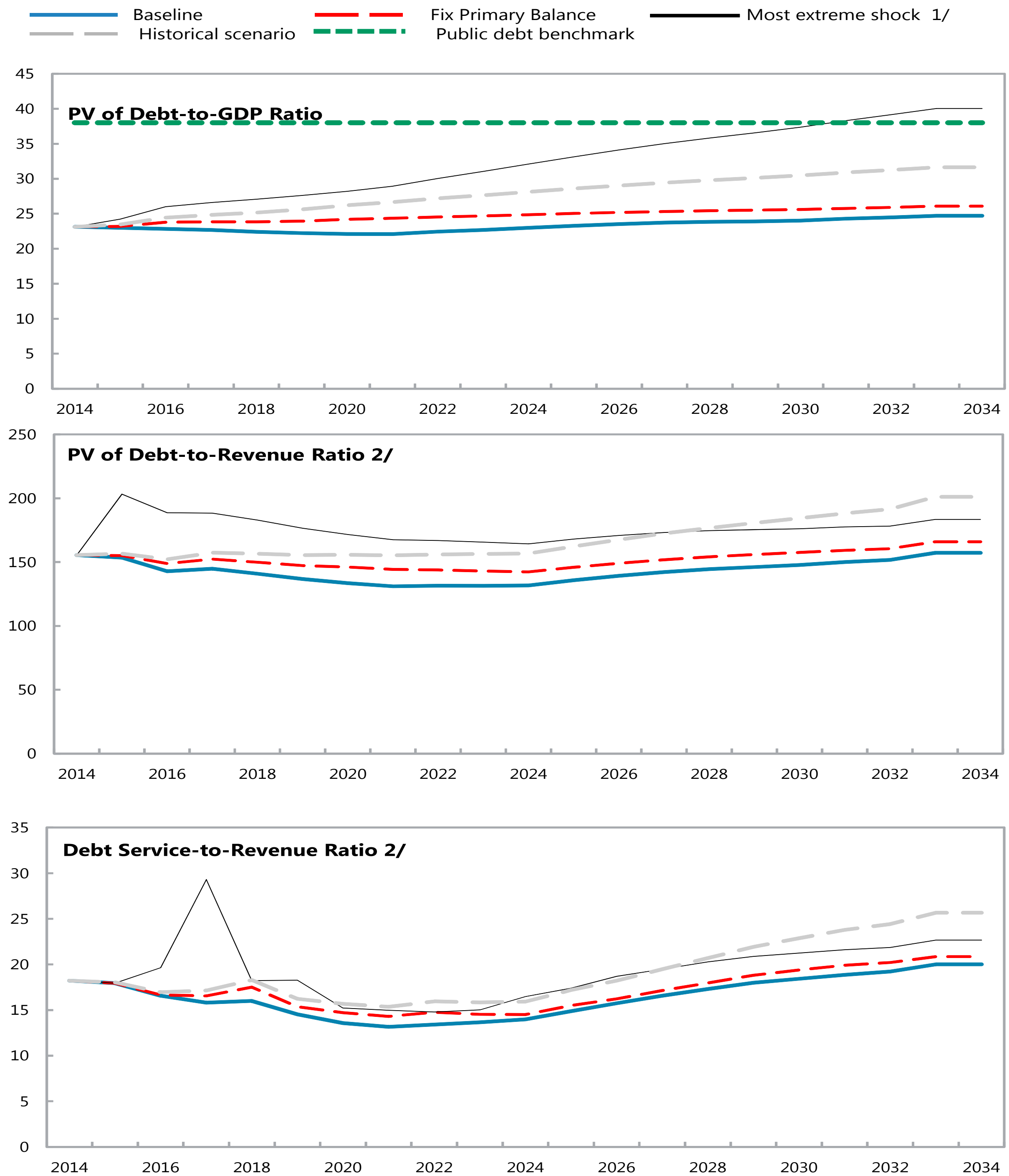
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

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.

Figure 3. Madagascar: Indicators Of Public Debt Under Alternative Scenarios, 2014–34



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.
2/ Revenues are defined inclusive of grants.

Table 7. Madagascar: Sensitivity Analysis for Key Indicators of Public Debt, 2014–34

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of Debt-to-GDP Ratio								
Baseline	23	23	23	23	22	22	23	25
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	23	23	24	25	25	26	28	32
A2. Primary balance is unchanged from 2014	23	23	24	24	24	24	25	26
A3. Permanently lower GDP growth 1/	23	23	23	24	24	24	28	43
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	23	24	26	27	27	28	32	41
B2. Primary balance is at historical average minus one standard deviations in 2015-201	23	25	27	26	26	26	26	27
B3. Combination of B1-B2 using one half standard deviation shocks	23	24	27	27	27	27	30	35
B4. One-time 30 percent real depreciation in 2015	23	28	27	27	26	25	25	27
B5. 10 percent of GDP increase in other debt-creating flows in 2015	23	30	30	30	29	29	29	29
PV of Debt-to-Revenue Ratio 2/								
Baseline	156	154	143	145	141	137	132	157
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	156	157	152	157	157	155	157	201
A2. Primary balance is unchanged from 2014	156	155	149	152	150	147	142	165
A3. Permanently lower GDP growth 1/	156	155	146	149	148	146	159	270
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	156	160	159	166	167	166	180	258
B2. Primary balance is at historical average minus one standard deviations in 2015-201	156	165	167	169	163	158	149	170
B3. Combination of B1-B2 using one half standard deviation shocks	156	163	164	169	167	165	169	224
B4. One-time 30 percent real depreciation in 2015	156	188	171	170	162	155	143	169
B5. 10 percent of GDP increase in other debt-creating flows in 2015	156	203	189	188	183	177	164	182
Debt Service-to-Revenue Ratio 2/								
Baseline	18	18	17	16	16	15	14	20
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	18	18	17	17	18	16	16	26
A2. Primary balance is unchanged from 2014	18	18	17	17	18	15	15	21
A3. Permanently lower GDP growth 1/	18	18	17	16	17	15	16	30
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	18	18	18	18	19	18	18	29
B2. Primary balance is at historical average minus one standard deviations in 2015-201	18	18	17	20	20	16	15	21
B3. Combination of B1-B2 using one half standard deviation shocks	18	18	18	19	20	17	17	26
B4. One-time 30 percent real depreciation in 2015	18	19	19	19	19	18	18	29
B5. 10 percent of GDP increase in other debt-creating flows in 2015	18	18	20	29	18	18	16	23

Sources: Country authorities; and 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.

Press Release No. 14/287
FOR IMMEDIATE RELEASE
June 18, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$47.1 Million Disbursement Under the Rapid Credit Facility for Madagascar

The Executive Board of the International Monetary Fund (IMF) today approved emergency financial assistance under the Rapid Credit Facility (RCF) in the equivalent of SDR 30.55 million (about US$47.1 million) for Madagascar to enable the authorities meet their urgent balance of payment needs.

The IMF financial assistance is in support of a set of economic and structural policies and measures the authorities plan to implement in order to restore macroeconomic stability, provide a favorable environment in support of inclusive growth and poverty reduction, and to strengthen the capacity of the Malagasy government. The Executive Board's approval of the RCF disbursement will also enable the authorities to engage in discussions with development partners' regarding further assistance. The Board's approval enables the immediate disbursement of the full amount, which is equivalent to 25 percent of Madagascar's quota in the IMF.

After several years of reasonably strong economic growth, output contracted in 2009 and remained weak over several years, given a high level of political and economic uncertainty that impacted investment decisions. Over this period, Madagascar also experienced dwindling financial support from development partners and enduring fiscal deficits that became progressively more difficult to finance. Supported by large mining projects that are reaching commercial production, recovering rice production, and a less uncertain political environment, growth is projected to increase to 3 percent in 2014.

The RCF provides immediate financial assistance with limited conditionality to low-income countries with an urgent balance of payments need. In this context, the economic policies of a member receiving RCF financing are expected to address the underlying balance of payments difficulties and support policy objectives including macroeconomic stability and poverty reduction. Financing under the RCF carries zero interest (until end 2014), has a grace period of 5.5 years, and a final maturity of 10 years. The Fund reviews the level of interest rates for all concessional facilities every two years.

Following the Executive Board discussion on Madagascar, Mr. Min Zhu, Deputy Managing Director and Acting Chair, said:

"Madagascar's re-engagement with the Fund marks the end of a difficult period of economic disruption in which economic activity slowed, investment stagnated and social and governance indicators weakened. Last year's elections, and subsequent widespread recognition of the new government by the international community, are helping to set the stage for a revival of the economy, but large balance of payments and fiscal gaps need to be filled in order not to jeopardize the economic recovery and to begin to address social needs.

"With support under the Fund's Rapid Credit Facility, the government intends to implement macroeconomic policies and structural reforms to correct macroeconomic imbalances, shore up growth and begin tackling high rates of poverty. Key challenges for fiscal policy in 2014 include easing disorderly spending compression, increasing outlays on infrastructure and essential government services, and developing a multi-year strategy to clear domestic budgetary arrears. Steps to boost fiscal revenues through improved tax and customs revenue administration and a broadened tax base, phased elimination of general fuel subsidies, and elimination of low-priority expenditures are key to creating room for more productive infrastructure and better targeted social spending. Exchange rate flexibility will be an important element in safeguarding and facilitating a steady rebuilding of foreign exchange reserves.

"Revitalizing structural reforms is a priority for fostering sustained growth and lasting reductions in poverty, with key areas being: public financial management, domestic revenue mobilization, and enhancing financial inclusion and deepening. Governance improvements will require building stronger institutions, enabling a level playing field for the private sector, creating incentives that reinforce proper conduct, and providing adequate resources for the control and audit of public entities.

"The Fund will continue to play a key role in facilitating international efforts in the provision of financial and technical assistance to support the government's reform strategy."

Statement by Mr. Kossi Assimaidou, Executive Director for Madagascar
June 18, 2014

On behalf of my Malagasy authorities, I would like to thank Management and the Board for the normalization of relations between the IMF and Madagascar, after five years of interruption, and following the election of a new President and the formation of a new Government. Soon after the normalization of relations, the President of Madagascar met with management at the IMF and expressed his strong determination to address the economic and financial challenges facing the country and his commitment to implement a restructuring plan to address the issues of growth and poverty, with the assistance of the international community and the Fund, in particular.

My Malagasy authorities are therefore thankful for the quick return of a mission to Madagascar in April 2014 to assess the economic and financial situation of the country. Based on this assessment, my Malagasy authorities are requesting Fund support under the Rapid Credit Facility (RCF). The authorities' policies will help to start addressing Madagascar's urgent economic and social needs, and enable them to start preparing a more comprehensive program of adjustment and reforms.

The authorities are very appreciative of the policy advice during the discussions, and also for the technical assistance provided by staff. They thank Management and staff for the efforts to bring expeditiously to the Board their request for assistance under the RCF. My authorities are hopeful that the program will help catalyze additional support from donors and other international agencies.

Economic Developments 2009-13

The Malagasy economy was severely affected during the five-year of political crisis. Economic activity slowed, external budget support was halted and social indicators deteriorated. There was also an accumulation of domestic arrears. However, fiscal and monetary policies remained prudent so that macroeconomic and financial stability were maintained.

Real economic growth fell by 3.5 percent in 2009 and averaged slightly more than 1 percent during the period 2010-13.The positive economic growth between 2011 and 2013 was related mainly to the foreign investments in the two large mining projects. Per capita income, however, declined during that period. Inflation remained at single digits, and the nominal exchange rate depreciated moderately.

The fiscal accounts were adversely affected by the drop in revenue, and led to an accumulation of domestic arrears. Moreover, starting in 2011, the authorities froze prices of fuel products at the pump to mitigate the impact of the rising international oil prices on the population. The national utility company, JIRAMA, was also accumulating losses as it had been operating inefficiently and its tariffs were below costs. As a result the government accumulated arrears which are estimated at about 3.8 percent of GDP at end-2013.

In the external sector, the current account deficit fluctuated during 2009-2013. Large investments in the development of the mining companies caused the current account deficit to widen to over 20 percent of GDP in 2009, financed by FDI, but by 2013 the deficit had declined to about 5.3 percent of GDP. Foreign exchange reserves which were equivalent to about 3.7 months of imports at end-2011 fell to about 2.2 months at end-2013 mainly due to decreasing FDIs, increased food prices and subsidies on petroleum imports, among others.

Policies for 2014

The RCF, which Madagascar is requesting, will support the implementation of the authorities' economic program for the rest of the year by helping to meet urgent balance of payments needs and play a catalytic role in mobilizing donors' support. Under the program, the authorities plan to address the most pressing needs of the country and lay the foundation for stronger growth and poverty reduction. In this context, a supplementary budget will be submitted to the National Assembly in July, and it envisages increases in spending on infrastructure and on essential government services. The higher expenditure is expected to be financed by increased revenue coming from measures being introduced following an internal diagnostics (with Fund technical assistance) of both tax and customs administrations, as described in the staff paper and with additional budget support.

The overall fiscal deficit for 2014, with the supplementary budget, is projected at 3.6 percent of GDP (on a cash basis). While some increases in social spending are projected under the supplementary budget, careful expenditure prioritization will be continued, so as not to accumulate any additional arrears. The resource envelope does not allow presently for the full clearance of arrears. However, the authorities have started discussions with creditors, and are putting in place a strategy to clear all arrears within a few years. As part of this strategy, the authorities are also considering a repurchase of some debts, within the concessionality guidelines.

Going forward, the authorities have made the improvement of public finance management a priority. In this regard, in line with the findings of the Public Expenditure and Financial Accountability assessment and the recent PFM diagnostic mission from the Fund, the authorities will take actions aimed at improving transparency, accountability and governance of public finances. Enhancing budget execution, monitoring and control will also be part of the reform, and the authorities will formulate a medium-term strategy to modernize the PFM system with donor support.

Regarding fuel subsidies, the authorities have taken the decision to eliminate them gradually, within the space of 12 months. This decision will be implemented together with a number of supporting measures, with the assistance of development partners, to mitigate the adverse impact on the poor. These include temporary and targeted subsidies for public transport in urban areas, an expansion of “cash-for-work” program in rural areas, cash transfers related to school participation and an expansion of the school-kits program to a larger number of regions.

Monetary policy will continue to be prudent and anchored on the agreed indicative targets on net domestic assets and net foreign assets for the remainder of the year. This policy stance should help to keep inflation low. The central bank will also start to rebuild its reserve cover, and allow the official exchange rate to be determined by market conditions.

The Malagasy authorities share the view that the financial sector can be an important instrument of growth. In this regard, they intend to take steps, with technical assistance from the Fund and other development partners, aimed at deepening the sector and making it more inclusive. Attention will also be given to improving banking system supervision and financial regulation, as well as developing a legal framework that incorporates best international practices in the area of anti-money laundering and combating financing of terrorism.

Conclusion

During the past five years, the Malagasy economy has stagnated, although the authorities were able to maintain macroeconomic stability. While real GDP growth fell, the external debt did not increase, the fiscal balance was, more or less, maintained, and the exchange rate was broadly stable. However, this balance was achieved through drastic cuts in social and capital spending, such that poverty has increased significantly.

It is the strong intention of the authorities to address the challenges that the economy faces. The RCF is the first step in this effort. With the expected return of donors and development partners in Madagascar, my authorities are working on a medium-term plan aimed at redressing the economy through a comprehensive program of structural reforms and supportive macroeconomic measures. This is being done in the context of a new poverty reduction and growth strategy (PRS) that should be ready before the end of the year. It is the intention of the authorities to present this macroeconomic program and an agenda of structural reforms to the Fund for support under the Extended Credit Facility. My authorities also expect that in this endeavor, they will receive the support of the international community, and it is their intention to discuss their medium-term plan with development partners in the context of a donor conference that could be held towards the last part of this year.

In light of the needs of the country and the strong determination of the authorities to restructure the economy and to implement policies that are conducive to sustainable growth, I would appreciate Directors' support for the Fund's assistance to Madagascar under the RCF as well as through technical assistance.