INTERNATIONAL MONETARY FUND

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REPUBLIC OF MADAGASCAR

August 2019

FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF MADAGASCAR

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

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 26, 2019, following discussions that ended on June 11, 2019, with the officials of Republic 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 July 11, 2019.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Republic of Madagascar.

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

Letter of Intent sent to the IMF by the authorities of Republic of Madagascar*
Memorandum of Economic and Financial Policies by the authorities of Republic of Madagascar*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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FOR IMMEDIATE RELEASE
July 26, 2019

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IMF Executive Board Completes Fifth Review of Extended Credit Facility Arrangement for Madagascar

On July 26, the Executive Board of the International Monetary Fund (IMF) completed the fifth review under the Extended Credit Facility (ECF) Arrangement for Madagascar. The completion of this review enables the disbursement of SDR 31.428 million (about US$43.7 million), bringing total disbursements under the arrangement to SDR 219.12 million (about US$304.5 million).

Madagascar's 40-month arrangement for SDR 220 million (about US$305 million, or 90 percent of Madagascar's quota) was approved on July 27, 2016 (see Press Release No.16/370). Additional access of 12.5 percent of Madagascar's quota was approved by the Executive Board in June 28, 2017, bringing Madagascar's access to SDR 250.55 million (about US$347 million) at that time. This arrangement aims to support the country's efforts to reinforce macroeconomic stability and boost sustained and inclusive growth.

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, made the following statement:

"Madagascar's performance under its economic program supported by the Extended Credit Facility (ECF) arrangement has remained generally strong. Growth has been solid, inflation has been moderate, and the external position has remained robust. Going forward, the authorities' continued commitment to strong policies and an ambitious structural reform agenda will be key to mitigating internal and external risks, strengthening macroeconomic stability, and achieving higher, sustainable, and inclusive growth.

"The authorities' economic reform agenda requires continued efforts to enhance investment capacity, essential for scaling up priority investment spending. Increasing social spending, as planned in the revised budget law, and developing social safety nets is also crucial. Further enhancing revenue mobilization through tax collection is central to this strategy and warrants renewed efforts to avoid eroding the tax base.

"Resolute actions are needed to contain risks to macroeconomic stability and debt sustainability, including fiscal risks from the financial situation of JIRAMA, the sustainability of the civil servant pension fund, and liabilities to the fuel distributors. On the latter, the recent progress towards the implementation of an automatic fuel pricing mechanism while limiting its impact on the poorest is encouraging.

“The recent adoption of the law on illicit asset recovery brings the anti-corruption legal framework into closer alignment with international standards. The authorities should continue to build on these efforts. Making further progress on modernizing public financial management and improving the business climate will be essential to promote good governance. Allocating sufficient human and financial resources will allow for effective enforcement of this framework.

“The ongoing reform agenda should continue to benefit from IMF technical assistance in various areas, such as fiscal policy, governance, and the monetary and financial sectors.”

INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

July 11, 2019

FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT

EXECUTIVE SUMMARY

Context. Despite some electoral cycle-related uncertainties—the preparation and holding of the Presidential election in December 2018 and Parliamentary elections in May 2019—economic developments remained favorable in 2018 and the first months of 2019. Macroeconomic slippages were limited, with spending strictly contained within budget limits. The stable functioning of public institutions allowed for continued implementation of the economic reform program.

Review. The authorities met all end-December 2018 performance criteria (PCs), despite shortfalls on revenue and social spending impacting the related indicative targets (ITs). Progress on the structural reform agenda slowed during the electoral cycle, but without jeopardizing the main objectives of the program. The program remains on track in 2019, with all PCs for end-June 2019 within reach. Staff recommends the completion of the fifth review under the ECF arrangement based on performance on the end-December 2018 targets and good prospects for the remainder of the program. Completion of the review will lead to disbursement equivalent to SDR 31.43 million, bringing total disbursements under the program to SDR 219.12 million (about $304 million).

Focus. Discussions focused on the recently adopted 2019 revised budget law, which reflects the priorities of the new government and accommodates additional investment spending without undermining the main program objectives, as well as on the two main challenges relating to fuel pricing and the losses of the public utility JIRAMA. Other issues discussed included the strengthening of social safety nets, reforms in the financial sector, and progress on governance.

Outlook and risks. The outlook continues to be generally positive, and the government appears committed to continuing its engagement with the IMF and the international community. Madagascar remains a fragile state, vulnerable to exogenous shocks, including to terms of trade and natural disasters and widespread poverty.

Approved By
David Owen (AFR) and Zuzana Murgasova (SPR)

Discussions on the authorities' economic and financial program took place in Antananarivo during May 29-June 11, 2019. The IMF staff team included Mr. Tsangarides (Head), Mr. Léost, and Mrs. Cheptea (all AFR), Mr. Behar (SPR), and Mr. Kabanda (FAD). The mission was assisted by Mr. Gerard (Resident Representative) and Ms. Rasoamanana (local economist). Messrs. Razafindramanana and Nguema-Affane (both OED) participated in the discussions. The IMF team met with Prime Minister Ntsay, Minister of Economy and Finance Randriamandrato, Minister of Energy, Water and Hydrocarbons Andriamanga, Central Bank of Madagascar Governor Rasolofondraibe, and other senior officials, as well as representatives of the private sector, civil society and development partners.

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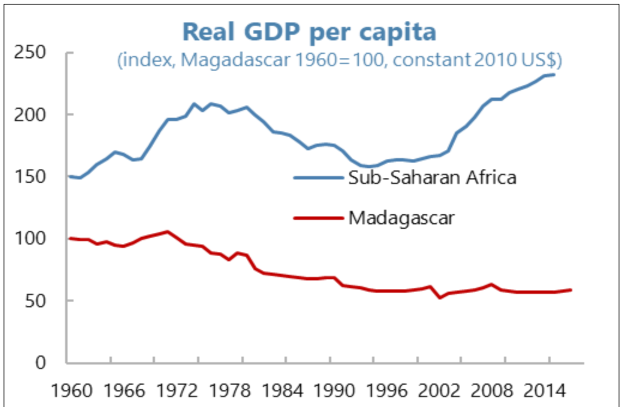
BACKGROUND

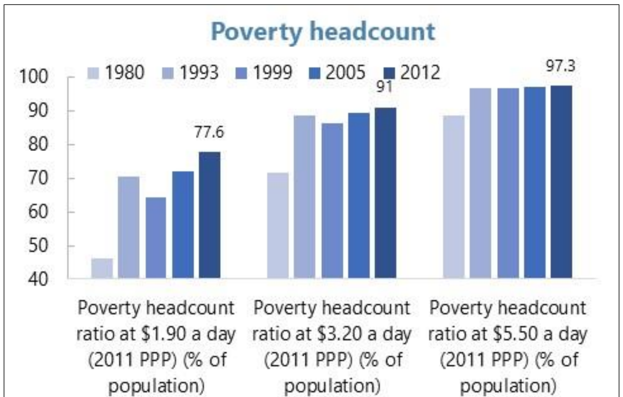
1. **Following the December 2018 Presidential elections, the May 2019 Parliamentary elections marked the end of the electoral period**. President Rajoelina was inaugurated on January 19, 2019—the first peaceful constitutional handover of power from one elected administration to another in decades. The President has committed to a strong economic reform agenda and the IMF-supported program, while calling for continued external support. Parliamentary elections took place on May 27, 2019 and the coalition supporting President Rajoelina won the majority of seats in the National Assembly.

2. **Economic conditions continued to improve in 2018, and implementation of the Fund-supported program remained generally strong**. Growth was strong and inflation moderate, the external position remained robust, and fiscal performance was good overall despite a temporary shortfall in revenue collection and some slippages in advancing the fuel pricing agenda. While progress continued toward the key objectives of the ECF-supported program, Madagascar remains a fragile state with low per capita GDP, widespread poverty, and exposure to natural disasters.

3. **The authorities are committed to the objectives of the ECF-supported program and are drafting an ambitious economic reform plan based on the President's reform agenda**. The government's priorities are consistent with the ECF-supported program objectives, including (i) raising economic growth based on the mobilization of tax revenues and the prioritization of spending, particularly towards investment; (ii) strengthening social policies and spending to reduce poverty and improve access to education, health, and housing; and (iii) improving governance and institutions. These priorities will be formalized in the forthcoming *Plan Emergence Madagascar.*



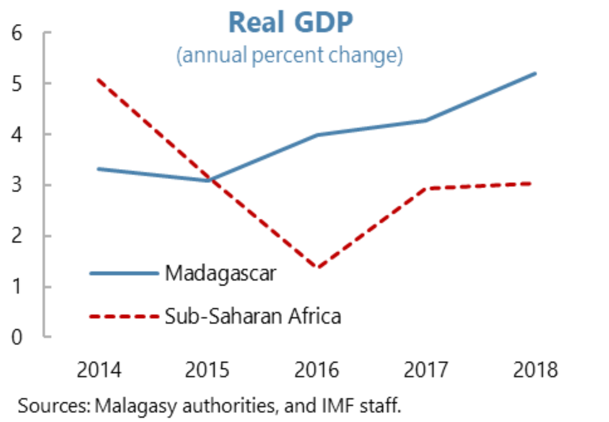
Source: IMF staff.



Source: World Development Indicators.

RECENT ECONOMIC DEVELOPMENTS

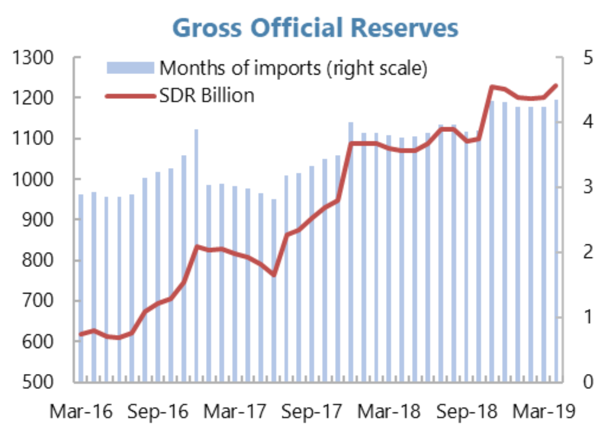
4. **Economic growth accelerated in 2018, with contained inflation**. Growth is estimated at 5.2 percent in 2018—the highest rate since 2008—driven notably by recovery in agriculture and public and private investment (Figure 1). Inflation decelerated to 6.1 percent year on year (y-o-y) in December in 2018 from a peak of 9 percent in late 2017 (Figure 2).



Sources: Malagasy authorities, and IMF staff.

5. **Despite some challenges in the second part of 2018, budget execution was broadly in line with plans** (Figure 3, MEFP, ¶3). After a strong performance in the first half of the year, gross tax revenue fell short in the second half (by 0.2 percent of GDP), due to a staff strike in tax administration and higher than planned VAT deductions. In addition, the cash-flow position was affected by the extension of the payment period for some oil distributors' tax liabilities (0.3 percent of GDP). Government spending was in line with the 2018 revised budget, except for some adjustments late in the year to compensate for the shortfall in tax revenue mainly on domestically financed investment (2.1 percent of GDP compared to 2.3 percent in the revised budget). Commercial bank financing of the deficit was weaker than expected in the run-up to the elections, but without major consequences as it strengthened late in the year.

6. **The external position remained strong**. The current account recorded a surplus of 0.8 percent of GDP in 2018 because of stronger mining and vanilla exports and higher inflows from current transfers. There was a slight current account deficit the first quarter of 2019 reflecting a decline in vanilla receipts and higher imports, including of primary materials. Preliminary analysis suggests that the external position remains stronger than implied by fundamentals and desirable policies, in line with the 2017 External Sector Assessment (ESA). The real effective exchange rate (REER) appreciated by 1 percent in the first quarter of 2019 after some election-related depreciation in 2018. The central bank (BFM) intervened following an algorithm developed with Fund TA to limit exchange rate volatility and, in conditions of sufficient stability, build reserves which stood at SDR1.2 billion at end-May 2019, covering more than 4 months of imports and within the targeted range of the 2017 ESA.



Sources: Malagasy authorities, and IMF staff.

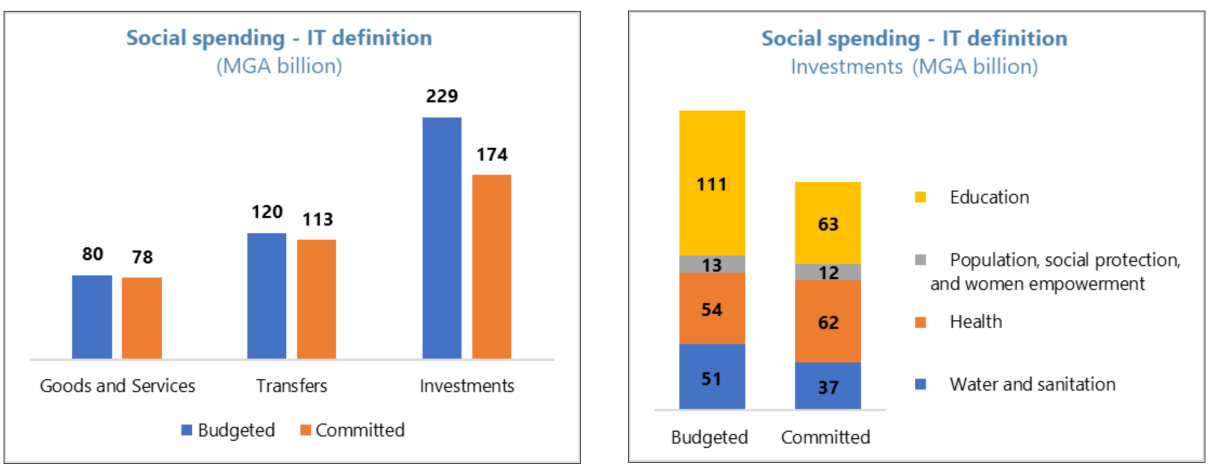
7. **The monetary stance continues to remain broadly adequate with the BFM managing the volatility of liquidity in the banking sector which remains healthy**. BFM interventions helped smooth volatility in bank reserves (mainly due to the historically high vanilla prices) in 2018 and in early 2019 (Figure 2). The pace of credit growth to the private sector remained healthy at about 12 percent y-o-y, on average in 2018, in real terms (Figure 4).

PROGRAM PERFORMANCE

8. **The authorities met all end-December 2018 performance criteria (PCs)** (Table 9a). The floor for central bank net foreign assets and ceiling on net domestic assets were achieved with margins, as were the PCs related to external debt. The PC on domestic primary balance—the fiscal anchor of the program—was also met (surplus of 0.1 percent of GDP), contrary to the small primary deficit estimated at the time of the fourth review (based on preliminary data). The small surplus was a result of lower domestically financed investment compared to the 2018 revised budget (by 0.2 per-cent of GDP) largely offsetting the shortfall in net tax revenue. The indicative target (IT) on tax revenues was not met, as over-performance in customs revenue did not fully offset the shortfall in domestic taxes. The IT on priority social spending was missed by 0.2 percent of GDP, as execution of domestically financed investment—some of which is allocated to social sectors—was lower than planned (Text figure 1).[1]

Text Figure 1. Indicative Target (IT) on Priority Social Spending in 2018

Compared to the IT of MGA 429 bn (1.1 percent of GDP), an amount of only MGA 365 bn (0.9 percent of GDP) was committed because of weak execution. This largely reflects under-execution of investment projects in education and, to a lesser extent, in water and sanitation. Health investment was above target. Social spending not classified as investment was within 5 percent of the budgeted amount.



Sources: Malagasy authorities, and IMF staff.

[1] The program IT for priority social spending is defined as domestically financed spending of four social ministries, excluding salaries. Other social spending can be identified in the budget of other ministries, but would be difficult to monitor on a quarterly basis. The choice of not including salaries is also common for such a target although it is debatable (especially for teachers or medical staffs). Finally, externally financed investments represent a large share of social spending but are not part of the IT as the government is not the decision maker (see Box 1 for more details).

9. The authorities also met all but one of the end-March 2019 ITs, and preliminary information suggests that the program remains on track in 2019. At end-March 2019 the only IT not met was the one on social spending due to general under-execution of the budget. Social spending is expected to increase strongly in the remainder of the year (¶14). All the PCs for end-June 2019 appear within reach, but the final assessment of performance at end-June 2019 will be made during the 6th ECF review when complete data are available.

10. Progress on the structural reform agenda has slowed during the election cycle. While the continuous SBs related to transparency on PPP contracts and JIRAMA's procurement were met, actions towards meeting other benchmarks were delayed. The new Tax Identification Number is used in all the directorates of the Ministry of Economy and Finance, but not in other ministries, and the submission to parliament of the new banking law (SB for end 2018) is now expected by end-July 2019 due to prolonged stakeholder consultations. The law on financial stability is ready to be submitted to parliament; it will be submitted (SB for end-June 2019) for the Parliament's first session (date to be confirmed), meeting the objective of the benchmark with a delay. At end-May 2019, the revised continuous benchmark on fuel pricing was observed (¶17).

OUTLOOK AND RISKS

11. The medium-term economic outlook remains generally favorable (Text table 1). Growth is projected to exceed 5 percent during 2019-20, supported by increased investment, improvements in the energy sector, and increased private sector activity including construction. Inflation is projected to be contained. The fiscal position is expected to remain robust, guided by the fiscal anchor of a positive domestic primary balance in the medium term. Higher investment-related imports and a partial retreat in vanilla prices are expected to contribute to a current account deficit of 1¾ percent in 2019 and rising deficits thereafter. The outlook, notably growth, will be reviewed in detail in the context of the upcoming Article IV.

12. Debt sustainability remains compatible with Madagascar's ongoing investment scaling up. An accompanying updated Debt Sustainability Analysis (DSA) uses a new framework, accounts for Madagascar's upgraded debt-carrying capacity, and expands the definition of public and publicly guaranteed (PPG) debt, which now includes domestic debt of State-Owned Enterprises (SOEs, 6 percent of GDP) and external liabilities of the central bank (4 percent of GDP). The DSA assesses Madagascar at low risk of external debt distress and at moderate risk of total public debt distress.

13. The favorable outlook remains subject to risks (Annex I). Growth could be lower than forecast if plans to accelerate public investment do not materialize as fast as expected, especially in 2019. Losses at SOEs could crowd out priority spending, and slower progress in reducing corruption could harm confidence. Madagascar remains highly vulnerable to terms-of-trade shocks and to natural disasters. Negative external developments, such as lower global growth, rising protectionism, and a retreat from multilateralism could reduce exports and donor assistance. Upside risks include larger multiplier effects of the planned scaling-up in infrastructure investment and current terms-of-trade gains unwinding more slowly than assumed in the projections.

Text Table 1. Madagascar: Medium-term Outlook

	2017	2018		2019		2020	2021	2022	2023	2024
	Est.	EBS 19/13	Est.	EBS 19/13	Proj.	Proj.				
Real GDP	4.3	5.2	5.2	5.2	5.2	5.3	5.1	4.9	4.8	4.8
Inflation (period average)	8.3	7.3	7.3	6.7	6.7	6.3	5.8	5.2	5.0	5.0
Domestic primary balance (percent of GDP)	-1.0	-0.3	0.1	0.1	-0.4	0.1	0.5	0.5	0.6	0.7
Public debt (percent of GDP)[1]	40.3	39.7	45.7	41.0	46.4	47.5	49.2	51.4	53.4	55.2
Current account balance (percent of GDP)	-0.5	0.3	0.8	-1.4	-1.9	-3.5	-4.3	-4.6	-4.8	-4.8
Official reserves (months of imports)	4.0	4.3	4.3	4.4	4.5	4.4	4.5	4.6	4.7	4.8

Source: Malagasy authorities, IMF.

[1]After EBS 19/13, includes debt of SOE's in which the government has a majority stake.

POLICY DISCUSSIONS

A. Promoting Pro-Growth and Inclusive Fiscal Policy

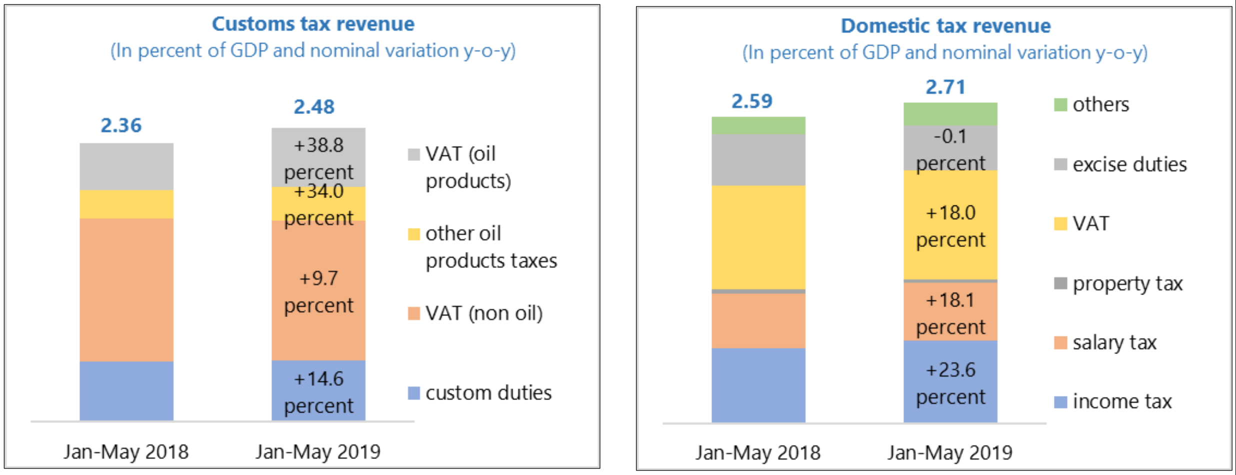
14. The revised 2019 budget law adopted in May reflects the priorities of the new government and remains in line with program objectives. Compared to the initial budget, there is a significant increase (0.6 percent of GDP) in the budget allocation to domestically financed public investments, partly compensated by the cancellation of non-essential credits, and the postponement of wage adjustment until May (0.2 percent of GDP in total). Other changes reflect modest increases in social and security spending. In terms of revenue, budget grants increased by 0.4 percent of GDP following updated commitments from the World Bank. These changes result in a small primary deficit (excluding foreign-financed investment and grants) of 0.4 percent of GDP, compared to a surplus of 0.1 percent in the initial budget. However, this does not endanger the achievement of the fiscal PC for end-June 2019 (last test date for the program) or the financing of the budget (¶16) and is consistent with the principle of spending rather than saving additional foreign official program support (TMU ¶30).

15. Implementation of the revised 2019 budget is feasible, but faces some challenges:

- The revised 2019 budget anticipates a **normalization of spending** which was largely under-executed in the first half of 2019. Due to the installation of the new government, the reorganization of ministries, and realignment of some budget lines, committed spending until end-May was almost exclusively limited to mandatory spending (wage bill, public pensions and debt service).
- The 2019 net **tax-to-GDP ratio target** of 12.3 percent of GDP is ambitious. Encouragingly, higher than expected customs revenues so far and a rebound in domestic revenues helped gross fiscal revenue exceed target for the first five months of 2019 by almost 0.2 percent of GDP (Text figure 2). Measures aimed at strengthening administrative reforms (with AFRITAC support) have continued to yield gains.

Text Figure 2. Recent Developments in Tax Revenue

In the first five months of 2019, gross tax revenue reached 5.2 percent of GDP, compared to 4.9 percent of GDP in the same period of 2018. Customs revenue increased by 18.1 percent year-on-year, and domestic tax revenue by 17.5 percent, confirming that the domestic revenue shortfall in the second half of 2018 may be temporary.



Sources: Malagasy authorities and IMF staff.

- The **wage bill** has been slightly lowered relative to the initial budget and restrained to 5.7 percent of GDP. The deficit of the **civil servant pension fund** remains contained at 0.7 percent of GDP and the authorities are working on incorporating credible assumptions in the 2020 budget, as well as implementing some measures from the reforms policy package proposed by an FAD mission in April 2019 to avoid an unsustainable deficit path going forward (MEFP, ¶16).

- The continued implementation of the revised 2019 budget of the **public utility JIRAMA** adopted in March 2019 consistent with government transfers of 0.6 percent of GDP (from 0.8 percent in 2018) depends on ambitious cost-saving measures with World Bank's support. Renegotiation of supplier contracts is in progress and ministries and public institutions have been instructed to clear outstanding bills to JIRAMA. These measures have started to contain risks of slippages, but should they fall short of objectives, contingency measures (including the acceleration of the introduction of additional smart meters, and non-replacement of retiring workers) will be activated to curtail further losses (MEFP, ¶14). A broader medium-term strategy supported by the World Bank seeks to balance the accounts of JIRAMA, address accumulated liabilities, and improve the production and distribution of electricity.

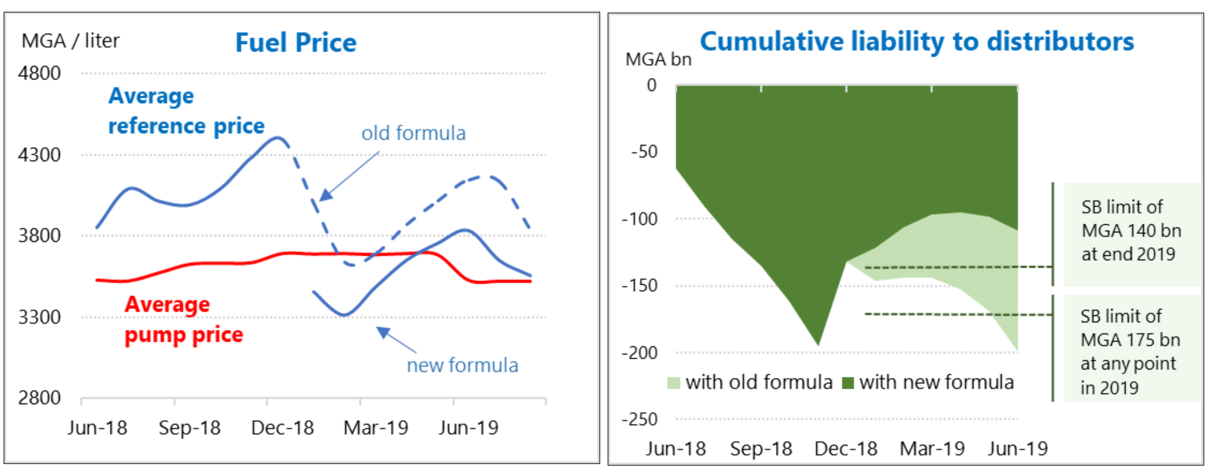
- **Public investment** is targeted to reach 8.3 percent of GDP, but execution remains challenging; in the first quarter of 2019 the overall execution rate was 71 percent driven by an execution rate of externally financed projects of 95 percent (while that of the domestically financed investments was only 16 percent). **Domestically-financed investment**—expected to rise to 3.4 percent of GDP with the additional spending planned in the revised budget—often remains a variable of adjustment (as in late 2018) to achieve budget savings, and **externally financed investment** is often under-executed compared to budget plans. Recent FAD TA confirmed persistent gaps at the planning, allocation, and implementation stages, and helped prepare a guide to streamline procedures, speed-up project management, and reduce administrative delays. The authorities are also strengthening oversight over project management, including through improved inter-ministerial coordination to ensure better project complementarity.

- Domestically-financed **priority social spending** could be higher than the 1.2 percent of GDP targeted in the budget, as part of the additional domestically financed investment spending, initially allocated at the ministry of Economy and Finance, will be reallocated to social ministries. Creating additional fiscal space is crucial to finance an ambitious medium-term social protection strategy (¶18 and Box 1).

16. The budget remains fully financed, with domestic financing conditions easing, and the approval of a $100 million budget grant (compared to $40 million originally planned) by the World Bank Board in April. Due to budget under-execution, the cash flow situation is comfortable, which allowed the repayment of all statutory advances in March 2019, and a build-up of government deposits at the central bank (1.2 percent of GDP at end-May 2019).

17. The plan to settle the liability related to fuel pricing and avoid its re-occurrence advanced and an agreement was reached with distributors on June 19. After several rounds of stakeholder discussions since February 2019, an agreement was reached on June 19, formalized by a Ministerial order signed on June 20 establishing a new reference price formula which reduces the reference price by about 12 percent (MEFP, ¶15). The government also decided to reduce pump prices by 4.5 percent, on average. (The reduction for kerosene, which is used by the poorest households, was almost 20 percent.) As a result, and with the new reference price applied from January 2019, the liability to oil distributors at end-June 2019 will be reduced to less than MGA 110 billion (0.2 percent of GDP), a level consistent with the limits of the continuous SB and the commitment for a gradual settlement of the liability by end-2020. With current parameters and the new formula, reference prices are estimated to be close to pump prices in August 2019, which reinforces the credibility of the plan to start implementing an automatic pricing mechanism in September 2019 (Annex II for details).

Text Figure 3. Fuel Price Developments and Liability to Distributors



Sources: Malagasy authorities, and IMF staff.

Box 1. Planned Social Spending in 2019

Priority social spending using the program definition is planned to reach 1.2 percent of GDP in 2019. According to the program definition (TMU, ¶22), priority social spending includes domestic spending on nutrition, education, health, and social safety nets (for monitoring purposes the sum of spending of the ministries of Health, Education, Population, and Water excluding salaries and externally financed investment). Under this restricted definition, priority social spending in the 2019 budget is planned to reach 1.2 percent of GDP in 2019 (from 0.9 percent in 2018).

The 2019 Revised Budget Law allocates an additional amount to priority social spending. Under the 2019 Revised Budget Law, additional domestically-financed investments of 0.6 percent of GDP allocated to the ministry of Economy and Finance will be redistributed among ministries depending on progress and priority of their investment projects. The authorities consider that about one third of this additional spending will be allocated to social sector ministries (MEFP, ¶14), which could raise priority social spending to about 1.4 percent of GDP, and plan to accelerate the launching of social projects by streamlining early procedures and emphasizing ex-post controls.

Using a broader definition, social spending could reach as much as 5 percent of GDP. If the definition of priority social spending is expanded to include salaries, externally financed social investments, and social spending in other ministries, social spending could reach about 5 percent of GDP in 2019. Indeed, some projects related to social sectors are implemented by non-social ministries, and therefore not accounted in the social IT. For instance, some interventions on nutrition and health (vaccination) are under the budget of the Prime Minister or the Presidency. The ministry of Economy and Finance oversees projects like the support for community and social development; the ministry of Energy has a project to distribute solar kits to the poorest communities; the ministry of Agriculture has many projects for the poorest rural areas (e.g. self-sufficiency agriculture and supporting women's work in agriculture).

	MGA bn	Percent of GDP
1. Social spending as defined in program IT (domestically financed spending of social ministries, excluding salaries)	**640**	**1.4**
1a. Initial budget law	**550**	**1.2**
Water and sanitation	60	0.1
Goods and Services	*0*	
Transfers	*3*	
Investments	*57*	
Health	135	0.3
Goods and Services	*31*	
Transfers	*32*	
Investments	*72*	
Population, social protection, and women empowerment	21	0.1
Goods and Services	*5*	
Transfers	*3*	
Investments	*13*	
Education	334	0.7
Goods and Services	*58*	
Transfers	*91*	
Investments	*185*	
1b. Additional domestic investment in social ministries (revised budget law)	**90**	**0.2**
2. Other social spending, not included in program IT	**1,565**	**3.5**
Salaries in social ministries (including teachers, medical staff)	1,036	2.3
Externally financed investments in social ministries	369	0.8
Spending in non-social ministries but dedicated to social	160	0.4
1+2. Total social spending, broad definition	**2,205**	**4.9**

Sources: Malagasy authorities, and IMF staff.

18. Ongoing strengthening of social safety nets is essential to fight poverty. Beyond subsidies to the urban public transport—which reach a small portion of the urban population and not necessarily the poorest households—it is crucial to improve existing social safety nets. Despite limited resources, the ministry of Population, Social Protection, and Empowerment of women has managed important programs with external partner support. Plans to expand existing safety nets cash transfer programs supported by the World Bank are ongoing, including through an additional $90 million grant approved in March 2019. Efforts towards gender equality are continuing through a dedicated directorate at the ministry of Population, with specific actions directed to economic empowerment of women, the establishment of legal counseling centers, and legislative changes.[2]

19. Over the medium term, further reforms will be needed to continue progress in creating fiscal space for much needed priority spending (MEFP, ¶16-19). These include:

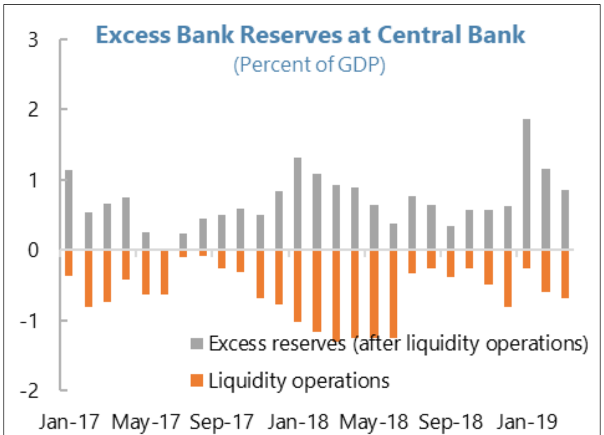
- **Further enhancing revenue mobilization**, building on continued progress in tax administration, stronger controls, better tax policy design (based on analysis, including on tax potential, provided by the tax policy unit created in 2017), and a strict control of potential costs associated with new tax incentives involved by the new laws on Special Economic Zones and on industrial development.

- **Reducing lower priority spending**, by eliminating transfers for operating losses of JIRAMA, containing the wage bill (while ensuring the quality of essential public services at a sustainable cost, and reforming the civil pension fund.

- **Managing fiscal risks**, notably those related to the expected take-off of PPP projects and the associated public guarantees.

B. Reinforcing Monetary Policy Effectiveness

20. Inflation remains under control, but bank liquidity needs to be more actively managed. Within the context of a flexible exchange rate regime, a policy combining foreign exchange reserve accumulation when conditions are favorable and liquidity operations to absorb excess bank reserves remains an appropriate response to the vanilla terms-of-trade shock. A more active liquidity management approach is nevertheless warranted, and is ongoing, in line with MCM recommendations. The recent introduction of fixed-rate liquidity operations will be complemented by fine-tuning of BFM operations to cope with unanticipated volatility.



Sources: Malagasy authorities, and IMF staff.

[2] Some of these efforts are already reflected in the gender diversity in the Ministry of Economy and Finance where about 30 percent of senior officials are women.

21. Progress towards interest rate-based monetary policy is continuing. With a view to incentivizing inter-bank lending (still at an embryonic stage despite recent signs of activity) and improving the transmission of monetary policy, a new overnight marginal facility rate was introduced in May, as a first step to establishing an interest rate corridor. A law on repurchase agreements (to be adopted by August 2019) was also prepared with TA, and implementation texts and technical conditions (including a dedicated electronic platform) are ready.

22. The authorities are making efforts to improve foreign exchange market operations and gradually phase out the surrender requirement on export proceeds. A draft law on the foreign exchange market, prepared with IMF technical assistance, is expected be submitted to Parliament by October 2019. The authorities have prepared a plan to gradually phase out the existing surrender requirement on export proceeds, which is considered a capital flow management measure under the IMF's Institutional View,[3] if market developments are conducive. Staff reiterated that the requirement should be temporary and phased out. The authorities emphasize that the market remains tight, regularly requiring interventions in the foreign exchange market to meet foreign exchange demand for imports of petroleum products.

C. Strengthening the Financial Sector to Support Inclusive Growth

23. The banking sector is generally healthy but faces some emerging challenges. Banks continue to be well capitalized, liquid and highly profitable, with non-performing loans accounting for 7.2 percent of total gross loans at end-2018, the lowest level since mid-2009. A few large banks (mostly subsidiaries of foreign banks) dominate the sector and are traditionally prudent, but new players are beginning to emerge. The development of smaller commercial banks activities, the growth of micro-finance institutions, and the rapid expansion of electronic money services pose new challenges for stability and supervision.

24. The new draft banking law addresses many of the FSSA recommendations on financial stability and systemic risks. The law, expected to be submitted by end-July 2019, reinforces the independence of the financial supervisor, improves the bank resolution framework, and strengthens the framework for corrective bank supervisory measures. Effective implementation of risk-based supervision is advancing, following the profiling of banks' risks on an individual basis with support of IMF TA. The law on financial stability, in line with international best practices, is expected to be submitted to Parliament by end-June 2019 (SB).

25. The authorities are implementing a strategy to improve financial inclusion. Preparatory work for the opening of a first private credit bureau was launched in January 2019. Building on an improved legal and regulatory framework, the authorities have licensed a new provider of electronic money services. State-owned non-bank financial institutions which play an important role for financial inclusion are adapting to new conditions, with the recent licensing of the public savings fund as a microfinance institution, and a development plan for the postal savings fund aimed at restoring its financial viability.

[3] IMF Country Report No. 17/223.

D. Promoting Better Governance and Business Climate

26. There has been significant progress in strengthening the anti-corruption framework. Several important laws have been adopted since 2016 (anti-corruption law; law on anti-corruption courts; law on international cooperation, and AML/CFT law adopted by Parliament in December 2018 and enacted), bringing Madagascar closer to international standards. The first anti-corruption court was opened in Antananarivo in June 2018, and the budget of the anti-corruption agency BIANCO has been increased.

27. The law on illicit asset recovery to complete the anti-corruption legal framework has been adopted by the Council of Minister and is awaiting Presidential promulgation shortly. This law was submitted to Parliament in December 2017, but its approval has been delayed, explained in part by the Presidential and Parliamentary elections. A draft ordinance—reflecting a consensus between anti-corruption agencies and the government—has been adopted by the Council of Ministers on June 28 and is awaiting Presidential promulgation shortly. This was an important step towards strengthening the anti-corruption legal framework. With a legal framework closer to international standards, further emphasis is needed on developing and reinforcing the institutions in charge of enforcing the laws, notably the anti-corruption center opened in Antananarivo in 2018.

28. Continuing progress in Public Financial Management (PFM) and improving the business climate is essential to further strengthen governance. Building on Fund FAD TA, the authorities have adopted a 2018-2026 Strategic Plan of Modernization of PFM, including its translation into an Action Plan for the 2018-2020 period (MEFP, ¶22). Further progress is also needed in the regulatory framework and rule of law (investor protection, contract enforcement and property rights), to facilitate international trade and the ease of establishing business.

OTHER PROGRAM ISSUES

29. Program targets remain unchanged for the rest of the program, including on external debt limits. Quantitative targets for end-June 2019—the last test date of the current arrangement—remain as proposed at the time of the 4th review (Table 9b). External debt limits are preserved despite the revised assessment of external debt distress because they suitably complement the existing conditionality on the fiscal balance, which has worked well so far; because important external debt vulnerabilities are still present, with indebtedness (including undisbursed contracted debt) projected to rise substantially; and because revisiting the limit so close to the final test date would likely have no practical consequences. Adherence to the continuous SB on fuel pricing—including the implementation of an automatic mechanism no later than end-September 2019—is part of the program conditionality.

30. Capacity development remains crucial to support the government's reform agenda. Priorities include reforms at the central bank, tax policy and administration, PFM, financial sector, and the anti-corruption legal framework and the implementation of the new AML/CFT law.

Discussions are taking place on evolving needs, and an updated Capacity Development Strategy Note will be prepared in the context of the upcoming Article IV.[4]

31. Data provision remains broadly adequate for surveillance and program purposes, with shortcomings identified and addressed gradually (MEFP, ¶31). The authorities are strengthening their participation in the enhanced General Data Dissemination System (e-GDDS), with a web-based National Summary Data Page launched in April 2019.[5] Rebased GDP figures[6] with the 1993 SNA methodology will be used for the preparation of the 2020 budget. The 2019 revised budget law and the framework for the current review use the current SNA methodology.

32. The BFM continues to implement the recommendations of the July 2018 safeguards monitoring report. Work is progressing as planned on the transition to International Financial Reporting Standards (IFRS) and in line with the BFM's commitment to fully adopt IFRS for the 2020 accounts (MEFP, ¶29). This transition is supported by a multi-stage IMF technical assistance. In addition, external audits continue to be timely and the FY 2018 financial statements are published.

33. Madagascar's capacity to repay the Fund remains strong (Table 14). Madagascar has a strong capacity to repay the Fund, with outstanding obligations projected to peak at 3.4 percent of GDP in 2019. Annual repayments, which increase in 2019 as Madagascar begins to repay the 2014 RCF disbursement, are expected to peak at 0.4 percent of GDP in 2025.

34. Risks to the program remain manageable. While the current economic situation appears favorable and sustainable, buffers are still limited and the materialization of some domestic or exogenous risks (¶13) could complicate the achievement of macroeconomic objectives. The authorities have reiterated their commitment to the program, but implementation risks remain significant given relatively limited capacity.

STAFF APPRAISAL

35. Despite the Presidential and Parliamentary elections in late 2018 and May 2019, respectively, economic developments remained favorable. Generally strong implementation of the authorities' economic program and some favorable economic conditions resulted in stronger macroeconomic outcomes, despite some weakening of economic confidence approaching the elections. Growth exceeded 5 percent in 2018, inflation continued to moderate, public finances remained sustainable, and the external position remained strong.

36. Implementation of the ECF-supported program remained generally strong in 2018. The authorities achieved all the end-December 2018 performance criteria, including on the domestic primary fiscal balance, despite a shortfall in tax revenue in the second part of the year. Progress on the structural agenda has slowed during the electoral cycle, but without jeopardizing the main objectives of the program in terms of redirecting lower priority spending to priority ones (education,

[4] See current strategy in IMF Country Report No. 18/239, Annex IV on Capacity Development Strategy.
[5] http://madagascar.opendataforafrica.org/pmidxic/national-summary-data-page-nsdp.
[6] The new GDP figures based on 1993 SNA methodology with 2007 base year are re-evaluated upward by about 16 percent, on average, over 2007-2017, and by 15 percent in 2017.

health, and essential infrastructure projects), strengthening the stability and development of the financial sector, and enhancing economic governance and the fight against corruption.

37. Effective implementation of the 2019 revised budget law, which remains in line with program objectives, is warranted. While reflecting the priorities of the new government—with a significant increase in the budget allocation to public investments—the revised budget law adopted in May 2019 remains on track to meet its fiscal objectives and remains fully financed. Given the large spending under-execution in the first half of the year, staff encourages a rapid acceleration for the rest of 2019, particularly on social spending. For some investment projects, spending procedures can be streamlined without undermining procurement rules and controls, following guidance from recent technical assistance recommendations.

38. Staff welcomes the recent agreement on a new fuel price structure and the authorities' continued discussions towards the implementation of an automatic fuel pricing mechanism. Delays in adjusting fuel pump prices in a context of volatile international oil prices led to increased liabilities to distributors which weigh negatively on the budget. The recent establishment of a new reference price formula is an important step for the implementation of the agreement signed on February 28, 2019 that begins the settlement of existing liabilities from the government to the fuel distributors. It also provides credibility to the authorities' reaffirmed plan to establish an automatic fuel price mechanism starting in September 2019. Staff also welcomes the decision to significantly reduce the price of kerosene, used by the poorest households.

39. For the medium term, continuing progress on creating fiscal space depends on intensified reforms. Priorities are on further enhancing revenue mobilization, pursuing the improvement in the quality and composition of spending, and actively managing fiscal risks. Among these risks is the potential impact on revenue from special regimes, the financial situation of JIRAMA, and the sustainability of the civil servant pension fund.

40. Staff welcomes the government's plans to increase social spending and develop social safety nets. While the implementation of the agreement on fuel pricing is not expected, under current conditions, to lead to significant pump price increases in the near future, staff welcomes the planned increase in social spending in the revised budget law, and the ongoing scaling-up of social safety net programs supported by the World Bank.

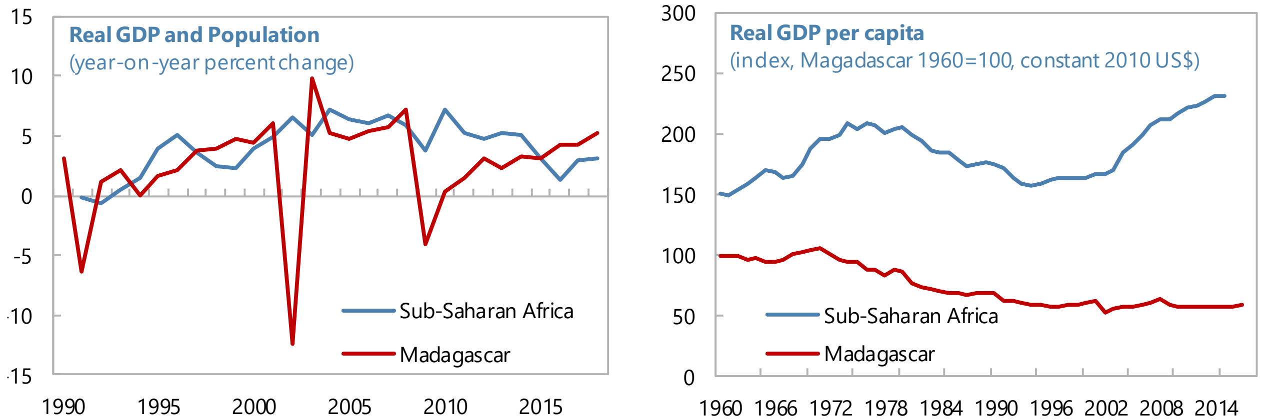
41. Staff welcomes progress on the anti-corruption legal framework and encourages increased efforts for its implementation. The enactment of the AML/CFT law adopted in December 2018, and the recent adoption of the law on illicit asset recovery by the Council of Ministers (awaiting Presidential promulgation shortly) bring Madagascar legal framework closer to international standards. Staff encourages a decided and impartial enforcement of these laws, which should start to show results.

42. Staff welcomes the continued progress on improving the monetary framework and strengthening the financial sector. The first steps taken towards interest-based monetary policy are encouraging, while efforts to build a sound and inclusive financial sector, based on FSSA recommendations, should continue. The new banking law and the law on financial stability, expected to be examined by the new Parliament during its first session, should strengthen financial stability and contain systemic risks, while also favoring financial inclusion.

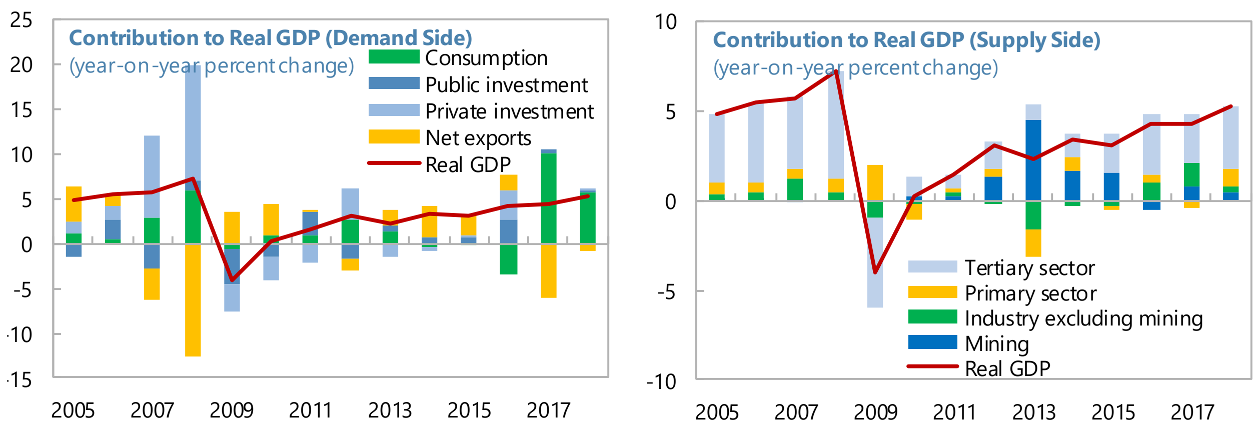
43. Based on Madagascar's performance under the program and the authorities' commitment to its objectives, staff recommends the completion of the fifth review under the ECF arrangement

Figure 1. Madagascar: Real Sector Developments

Despite recent improvements, growth in Madagascar has been insufficient to offset population growth and raise living standards.

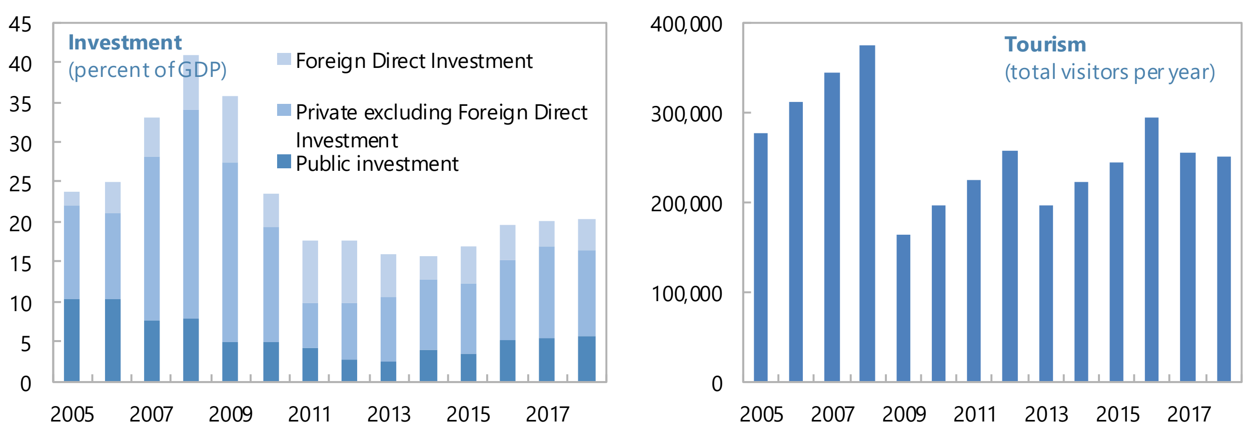


In recent years, consumption has been a key driver of growth on the demand side; on the supply side, growth is driven by the tertiary sector and a recent rebound in agriculture.



Investment is slowly recovering since 2015…

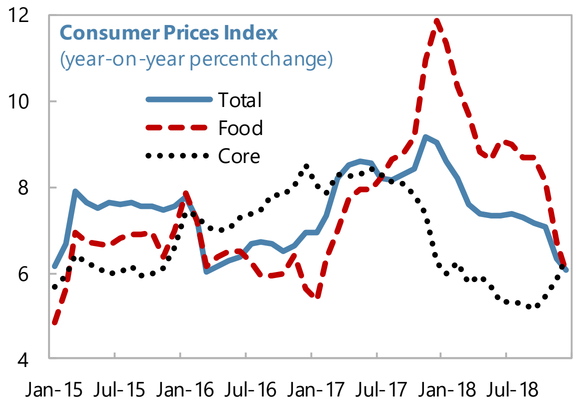
… while tourism is struggling to regain its 2008 level.

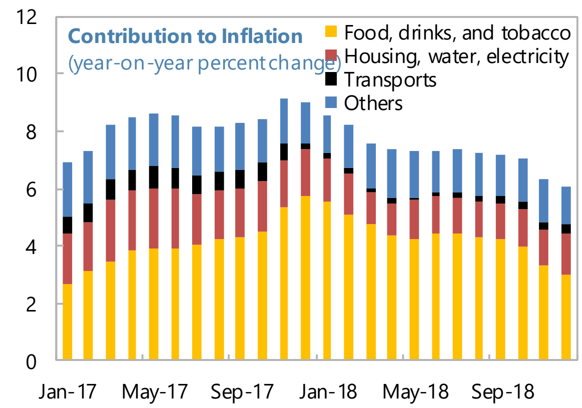


Sources: Malagasy Authorities; and IMF staff estimates.

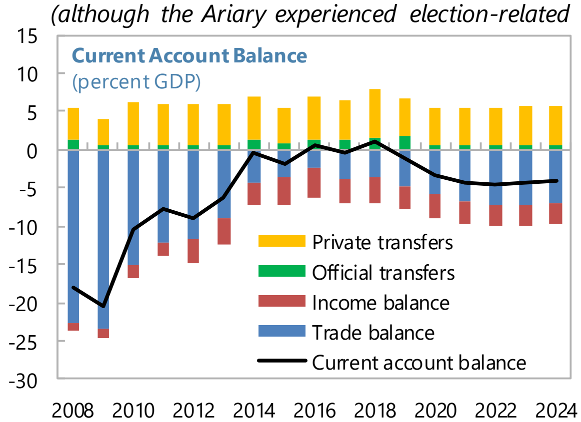
Figure 2. Madagascar: Inflation and External Developments

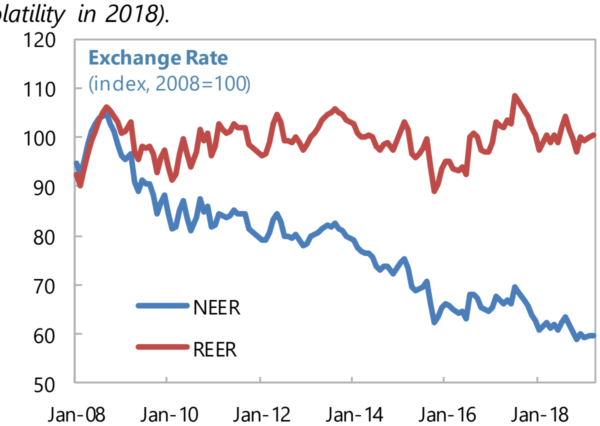
After peaking in late 2017, inflation gradually declined in 2018 towards 6 percent year-on-year.



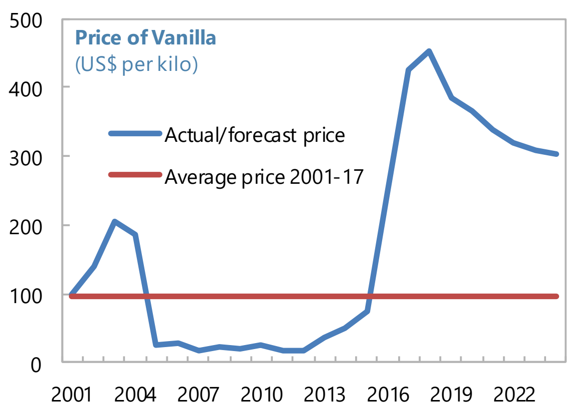


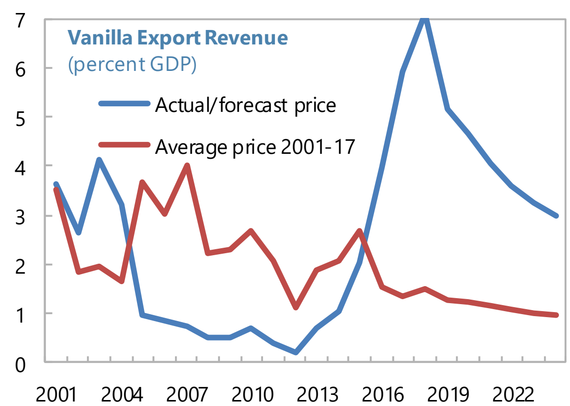
The current account has benefited from mining and vanilla exports but is expected to weaken as scaled-up public investment drives imports. The real effective exchange rate has remained relatively constant (although the Ariary experienced election-related volatility in 2018).





Export revenues have been boosted by high vanilla prices, which are expected to gradually unwind.

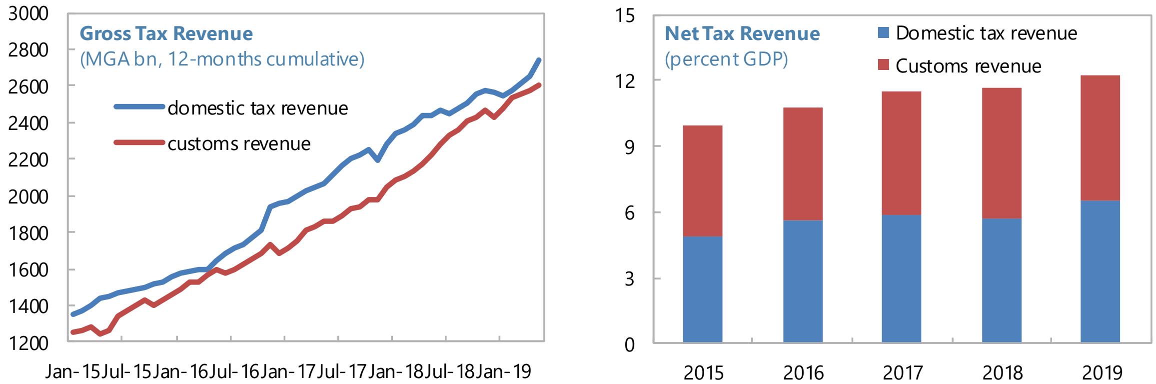




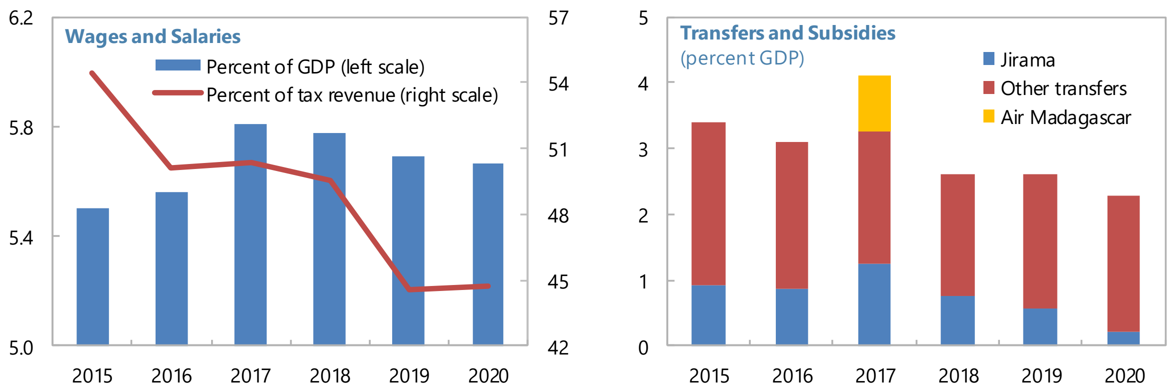
Sources: Malagasy Authorities; and IMF staff estimates.

Figure 3. Madagascar: Government Revenue and Spending

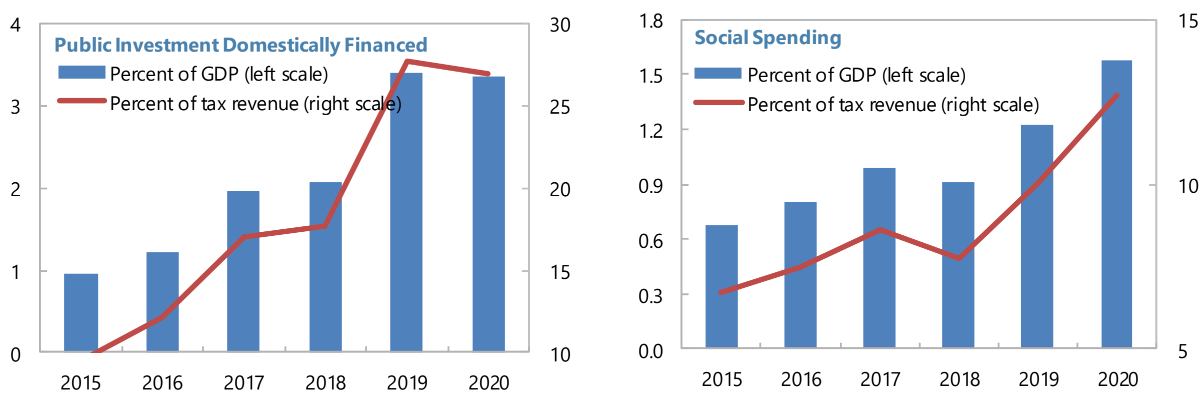
Tax revenue has risen by almost 2 percentage points of GDP in three years (between 2015 and 2018).



Despite unexpected needs for wages and transfers (mainly to public utility JIRAMA), spending composition is improving…



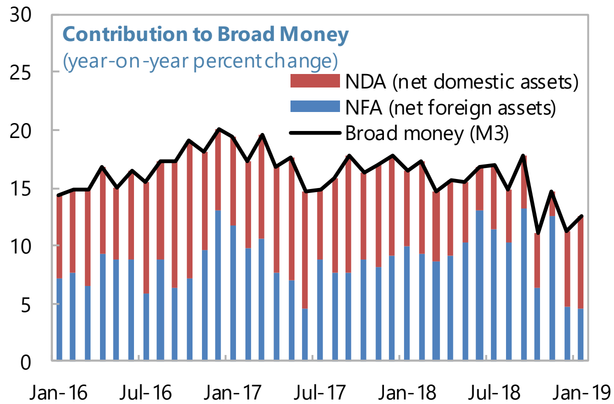
… with higher public investment and increasing social spending (from a low base).

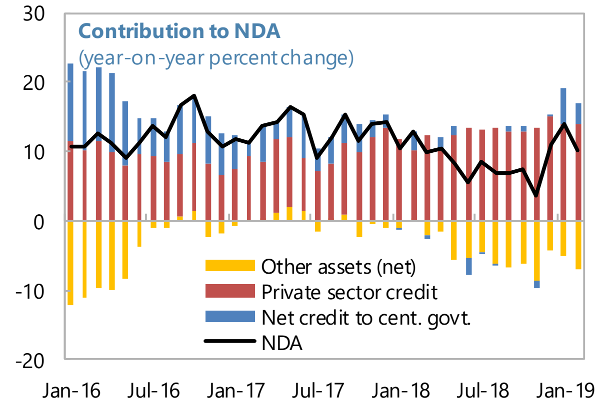


Sources: Malagasy Authorities; and IMF staff estimates.

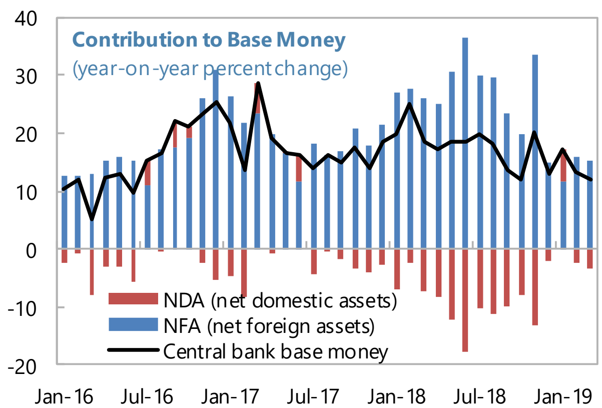
Figure 4. Madagascar: Monetary Developments

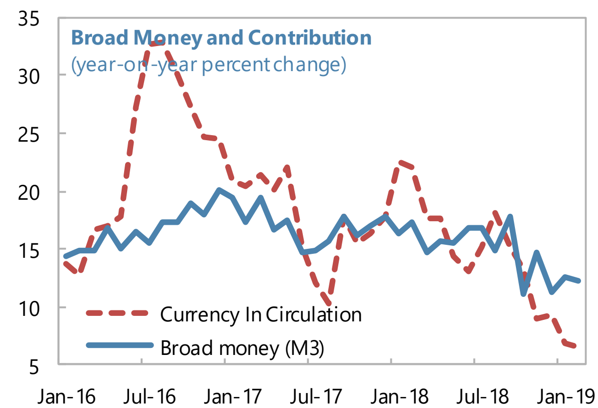
Broad money growth is driven by the accumulation of net foreign assets and credit to the private sector.



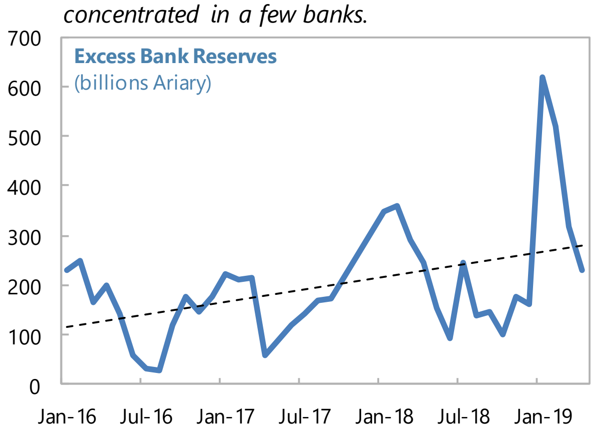


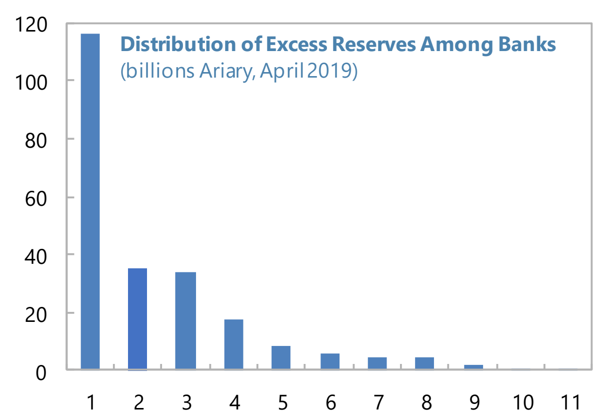
Base money growth is also driven by net foreign assets, while the demand for currency is supported by the vanilla boom in the context of a low bankarization of vanilla producers (mainly small-scale farmers).





Excess bank reserves are volatile (with strong seasonality in connection with the cycle of vanilla) and concentrated in a few banks.

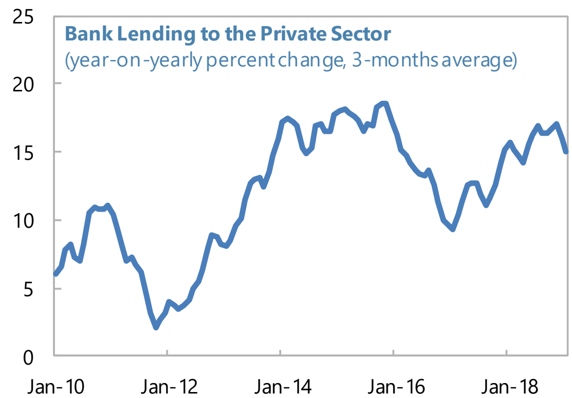


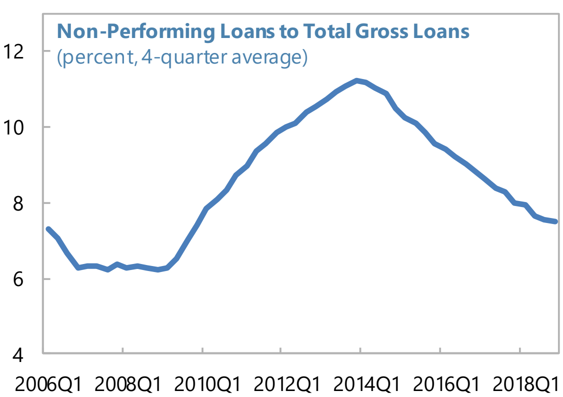


Sources: Malagasy Authorities; and IMF staff estimates.

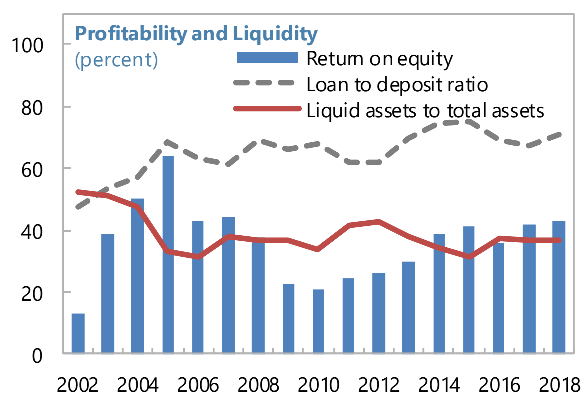
Figure 5. Madagascar: Financial Sector Developments

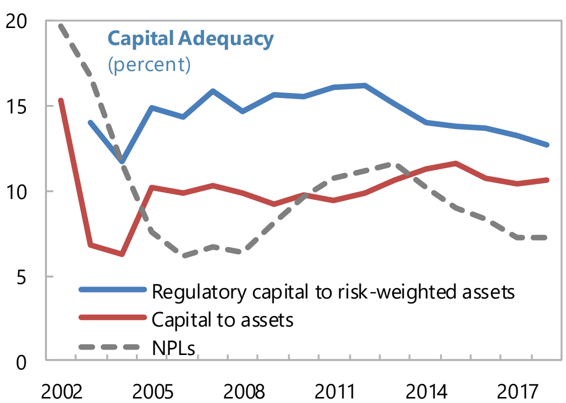
Credit is increasing at a healthy pace, and NPLs have been decreasing since their peak in late 2013.



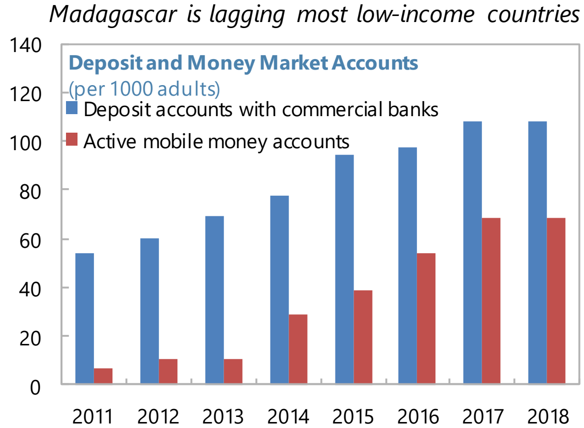


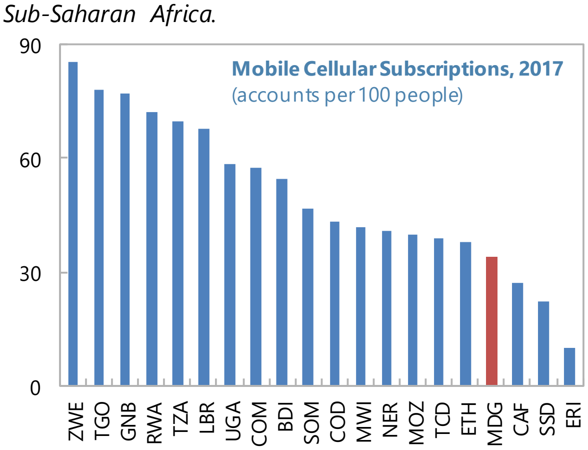
Overall, banks are well capitalized, liquid, and very profitable, but with significant differences among banks.





The rapid increase in mobile banking activities is a vector of development for the financial sector, even if Madagascar is lagging most low-income countries in Sub-Saharan Africa.

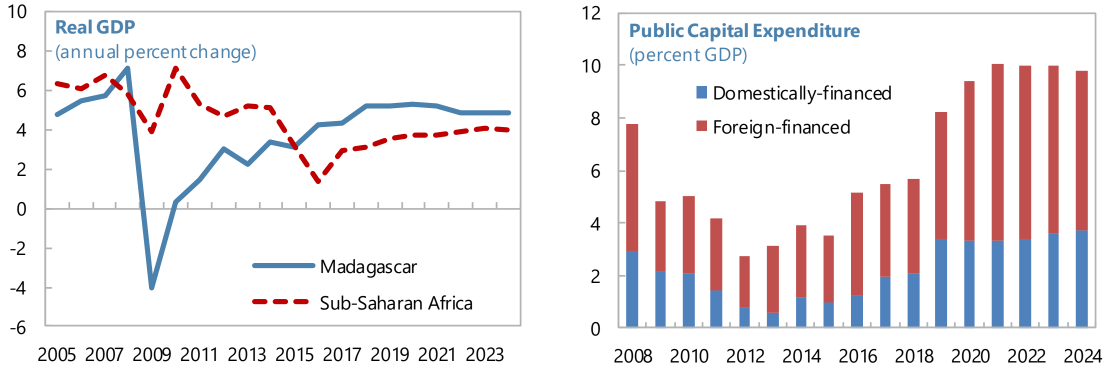




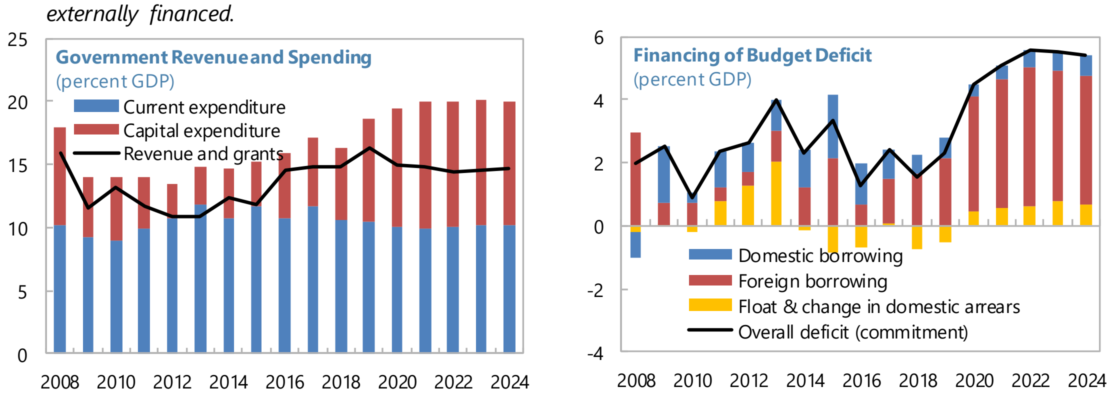
Sources: Malagasy Authorities; 2017 IMF Financial Access Survey; World Bank; and IMF staff estimates.

Figure 6. Madagascar: Medium-Term Macroeconomic Prospects

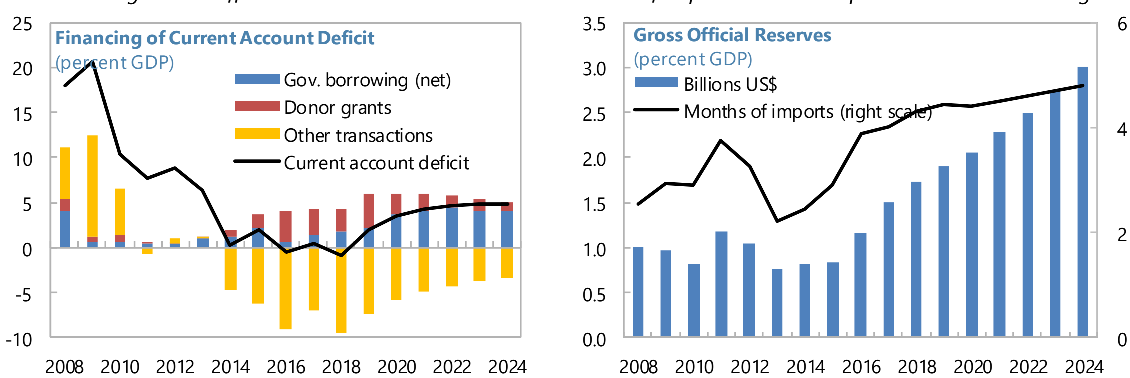
Growth is expected to remain above the Sub-Saharan average, sustained by scaled-up public investment.



The public investment scaling up is increasing the fiscal deficit (expected to peak in 2020), which is largely externally financed.



Investment-driven rises in the current account deficit will be financed by concessional government borrowing. Gross official reserves cover more than 4 months of imports and are expected to continue rising.



Sources: Malagasy Authorities; and IMF staff estimates.

Table 1. Madagascar: Selected Economic Indicators, 2016-24

	2016	2017	2018		2019		2020	2021	2022	2023	2024
	Actuals	Prel. Est.	EBS 19/13	Prel. Est	EBS 19/13	Proj.	Projections				
	(Percent change; unless otherwise indicated)										
National account and prices											
GDP at constant prices	4.2	4.3	5.2	5.2	5.2	5.2	5.3	5.1	4.9	4.8	4.8
GDP deflator	8.5	6.5	7.3	7.3	6.7	6.7	6.3	5.8	5.2	5.0	5.0
Consumer prices (end of period)	7.0	9.0	6.1	6.1	6.4	6.4	6.0	5.4	5.0	5.0	5.0
Money and credit											
Reserve money	25.4	18.6	11.8	13.0	16.8	17.3	12.3	10.0	9.9	9.1	9.0
Broad money (M3)	20.1	17.8	11.2	11.2	16.7	15.7	13.5	13.0	12.8	12.7	11.9
	(Growth in percent of beginning of period money stock (M3))										
Net foreign assets	13.0	9.2	4.8	4.8	4.6	6.2	5.9	7.0	6.4	7.1	7.1
Net domestic assets	7.0	8.6	6.4	6.4	12.1	9.6	7.6	6.1	6.4	5.6	4.8
of which: Credit to the private sector	4.1	8.4	8.7	8.7	6.9	7.4	5.7	5.3	4.9	4.3	3.9
	(Percent of GDP)										
Public finance											
Total revenue (excluding grants)	11.1	11.9	12.0	12.0	12.5	12.5	12.6	12.9	13.1	13.4	13.7
of which: Tax revenue	10.8	11.5	11.7	11.7	12.3	12.3	12.4	12.7	12.9	13.2	13.5
Grants	3.4	2.9	2.9	2.8	3.4	3.9	2.4	1.9	1.4	1.2	0.9
of which: budget grants	0.7	0.8	1.0	1.0	1.2	1.7	0.1	0.0	0.0	0.0	0.0
Total expenditures	15.8	17.2	17.1	16.3	18.4	18.7	19.4	19.9	20.0	20.1	20.0
Current expenditure	10.7	11.7	10.9	10.7	10.5	10.4	10.1	9.9	10.0	10.1	10.2
Wages and salaries	5.6	5.8	5.8	5.8	5.8	5.7	5.7	5.6	5.7	5.7	5.7
Interest payments	0.9	0.8	0.9	0.9	1.0	1.0	0.9	0.8	0.9	0.9	0.9
Other	3.7	4.9	3.5	3.5	3.5	3.5	3.3	3.3	3.3	3.4	3.5
Goods and Services	0.6	0.8	0.9	0.9	1.0	0.9	1.0	1.1	1.2	1.3	1.4
Transfers and Subsidies	3.1	4.1	2.6	2.6	2.5	2.6	2.3	2.2	2.1	2.1	2.1
Treasury operations (net)	0.6	0.2	0.7	0.5	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Capital expenditure	5.2	5.5	6.2	5.7	7.9	8.3	9.4	10.1	10.0	10.0	9.8
Domestic financed	1.2	2.0	2.3	2.1	2.8	3.4	3.3	3.4	3.4	3.6	3.7
Foreign financed	3.9	3.5	3.9	3.6	5.1	4.9	6.0	6.7	6.6	6.4	6.1
Overall balance (commitment basis)	-1.3	-2.4	-2.2	-1.5	-2.5	-2.3	-4.5	-5.1	-5.6	-5.5	-5.4
Float (variation of accounts payable, + = increase)[1]	0.5	0.7	0.1	-0.2	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0
Variation of domestic arrears (+ = increase)	-1.2	-0.6	-0.6	-0.6	-0.3	-0.3	-0.1	-0.1	0.0	0.0	0.0
Overall balance (cash basis)	-2.0	-2.3	-2.6	-2.3	-3.3	-2.8	-4.6	-5.2	-5.6	-5.6	-5.5
Domestic primary balance (new program definition) [2]	0.1	-1.0	-0.3	0.1	0.1	-0.4	0.1	0.5	0.5	0.6	0.7
Excluding Central Bank recapitalization					*0.3*	*-0.2*					
Total financing	2.0	2.3	2.6	2.3	3.3	2.8	4.0	4.5	5.0	4.8	4.7
Foreign borrowing (net)	0.7	1.4	1.9	1.7	2.3	2.1	3.7	4.1	4.4	4.2	4.1
Domestic financing	1.3	0.9	0.7	0.6	0.9	0.7	0.4	0.4	0.6	0.6	0.6
Excess financing [3]	0.0	0.0	0.0	0.0	0.0	0.0	-1.7	-2.7	-3.2	-3.7	-3.9
of which: budget support to be programmed	0.0	0.0	0.0	0.0	0.0	0.0	-0.6	-0.7	-0.7	-0.8	-0.7
Savings and investment											
Investment	19.7	20.1	19.7	20.4	20.8	22.4	23.6	24.4	24.5	24.6	24.4
Gross national savings	20.3	19.6	20.0	21.2	19.4	20.9	20.2	20.2	19.9	19.8	19.5
External sector											
Exports of goods, f.o.b.	21.4	24.4	24.8	25.1	24.0	23.3	23.1	22.5	21.9	21.5	21.2
Imports of goods, c.i.f.	28.2	31.5	31.4	31.6	32.1	32.1	32.5	32.5	32.5	32.4	32.2
Current account balance (exc. grants)	-2.9	-3.3	-2.6	-2.2	-4.8	-5.8	-5.9	-6.1	-5.9	-6.0	-5.8
Current account balance (inc. grants)	0.6	-0.5	0.3	0.8	-1.4	-1.9	-3.5	-4.3	-4.6	-4.8	-4.8
Public debt	47.1	46.0	39.7	45.7	41.0	46.4	47.5	49.2	51.4	53.4	55.2
External Public Debt [4]	29.6	29.5	30.2	30.5	31.7	31.8	33.6	35.8	38.3	40.6	42.5
Domestic Public Debt [5]	17.5	16.5	9.5	15.2	9.3	14.6	13.9	13.4	13.0	12.8	12.7
	(Units as indicated)										
Gross official reserves (millions of SDRs)	834	1,086	1,221	1,221	1,369	1,372	1,469	1,608	1,740	1,885	2,033
Months of imports of goods and services	3.9	4.0	4.3	4.3	4.4	4.5	4.4	4.5	4.6	4.7	4.8
Real effective exchange rate (period average, perc.	-0.3	7.3	-4.2	-4.2	…	…	…	…	…	…	…
Terms of trade (percent change, deterioration -)	81.4	14.3	3.7	5.7	-7.5	-15.5	-3.1	-0.6	-0.9	-0.5	-0.3
Memorandum items											
GDP per capita (U.S. dollars)	406	448	459	459	471	464	491	517	542	569	597
Nominal GDP at market prices (billions of ariary)	32,166	35,722	40,326	40,318	45,243	45,247	50,628	56,295	62,085	68,343	75,209

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

[1] The increase in the float in 2017 is largely due to delays in completing transfers linked to Air Madagascar that will now be paid in 2018.

[2] Primary balance excl. foreign-financed investment and grants. Commitment basis. Includes CB recapitalization of 0.2 percent of GDP in 2019.

[3] A negative value indicates allocated financing with the disbursement schedule to be agreed.

[4] After EBS 18/66, definition expanded to include BFM foreign liabilities for all years.

[5] After EBS 19/13, definition expanded to include debt of SOE's in which the government has a majority stake.

Table 2. Madagascar: National Accounts, 2016-24

	2016	2017	2018		2019		2020	2021	2022	2023	2024
	Actuals	Prel. Est.	EBS 19/13	Prel. Est.	EBS 19/13	Proj.	Projections				
					(Percent change)						
Real supply side growth											
Primary sector	1.8	-1.0	4.8	4.8	2.5	2.5	2.8	2.4	2.3	2.1	2.1
Agriculture	1.3	-6.6	9.2	9.2	3.2	3.3	3.8	3.2	3.0	3.0	3.0
Cattle and fishing	2.0	4.5	1.9	1.9	2.0	2.0	2.0	1.9	1.9	1.4	1.4
Forestry	3.3	1.0	-0.9	-0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Secondary sector	2.6	8.8	5.4	5.5	7.1	7.1	7.4	6.8	6.7	6.7	6.6
Food and drink	6.4	6.8	6.4	6.4	5.9	5.9	6.0	5.0	4.7	4.4	4.4
Export processing zone	10.8	25.2	2.0	2.0	13.0	13.0	12.0	11.5	11.5	11.5	10.5
Energy	6.5	6.6	8.4	8.4	11.5	11.5	11.5	10.0	9.5	9.0	8.7
Extractive industry	-6.3	9.8	5.4	5.4	6.5	6.5	7.5	7.5	7.5	7.5	7.5
Other	5.4	4.8	4.2	4.2	4.0	4.3	4.5	4.1	4.2	4.2	4.2
Tertiary sector	3.8	5.4	5.2	5.2	5.8	5.8	5.9	6.0	5.4	5.4	5.3
Transportation	3.5	6.5	6.2	6.2	7.6	7.6	6.9	7.0	7.0	7.0	6.9
Services	4.7	7.9	6.7	6.7	5.7	5.8	6.0	5.1	5.1	5.1	4.9
Trade	3.3	3.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Public administration	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Public works/construction	5.9	4.0	6.0	6.0	9.7	9.7	11.5	13.4	7.7	7.8	7.7
Indirect taxes	11.8	5.4	5.4	5.4	5.7	5.7	5.0	5.0	5.0	5.0	5.0
Real GDP at market prices	4.2	4.3	5.2	5.2	5.2	5.2	5.3	5.1	4.9	4.8	4.8
Nominal demand side composition					(Percent of GDP)						
Resource balance	-2.2	-3.8	-4.3	-3.7	-5.5	-4.8	-6.0	-7.0	-7.4	-7.4	-7.1
Imports of goods and nonfactor services	35.3	39.4	39.8	39.8	40.9	40.3	41.8	42.3	42.0	41.5	40.9
Exports of goods and nonfactor services	33.1	35.5	35.5	36.2	35.3	35.6	35.8	35.3	34.6	34.0	33.8
Current account balance (including grants) = (S-I)	0.6	-0.5	0.3	1.1	-1.4	-1.2	-3.5	-4.3	-4.6	-4.5	-4.1
Consumption	82.5	83.7	84.6	82.9	84.7	82.6	82.7	82.4	83.0	83.5	83.8
Government	9.8	10.9	10.0	9.8	9.6	9.6	9.2	9.1	9.3	9.4	9.4
Nongovernment	72.7	72.8	74.5	73.1	75.2	73.1	73.5	73.3	73.8	74.1	74.4
Investment (I)	19.7	20.1	19.7	20.7	20.8	22.1	23.3	24.6	24.3	24.0	23.3
Government	5.2	5.5	6.2	6.0	7.9	8.0	9.0	10.2	9.9	9.4	8.8
Nongovernment	14.5	14.7	13.5	14.8	12.9	14.2	14.3	14.4	14.5	14.6	14.6
Of which: foreign direct investment	4.5	3.1	3.9	4.1	2.7	4.1	4.1	4.1	4.1	4.0	4.0
National savings (S)	20.3	19.6	20.0	21.8	19.4	21.0	19.8	20.3	19.8	19.4	19.3
Government	3.9	3.0	4.0	4.0	5.3	5.4	4.9	5.1	4.8	4.9	4.8
Nongovernment	16.4	16.6	16.0	17.8	14.0	15.5	15.0	15.2	15.0	14.6	14.5
Memoranda items:											
					(Billions of Ariary)						
Nominal GDP (at market prices)	32,166	35,722	40,326	40,318	45,243	45,247	50,628	56,295	62,085	68,343	75,209

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

Table 3. Madagascar: Fiscal Operations of the Central Government, 2017-24

(Billions of Ariary)

	2017	2018		2019								2020	2021	2022	2023	2024
	Dec	Dec		March		June		Sep		Dec		Dec	Dec	Dec	Dec	Dec
	Prel. Est.	EBS 19/13	Prel. Est.	EBS 19/13	Prel. Est.	EBS 19/13	Proj.	EBS 19/13	Proj.	EBS 19/13	Proj.	Projections				
Total revenue and grants	5,272	6,016	5,971	1,513	1,472	3,272	3,454	5,219	5,229	7,185	7,407	7,587	8,342	8,962	9,980	10,992
Total revenue	4,240	4,844	4,837	1,213	1,310	2,753	2,719	4,171	4,170	5,647	5,647	6,379	7,278	8,120	9,165	10,291
Tax revenue [1]	4,118	4,725	4,706	1,202	1,299	2,693	2,656	4,079	4,076	5,545	5,545	6,265	7,151	7,980	9,011	10,121
Domestic taxes	2,094	2,334	2,315	620	617	1,458	1,360	2,165	2,112	2,955	2,955	3,439	4,008	4,602	5,309	6,146
Taxes on international trade and transactions	2,024	2,391	2,391	582	681	1,236	1,296	1,915	1,964	2,590	2,590	2,826	3,143	3,378	3,702	3,975
Non-tax revenue	122	119	131	11	12	60	62	92	95	102	102	114	127	140	154	170
Grants	1,032	1,172	1,134	300	162	519	735	1,048	1,058	1,538	1,760	1,208	1,064	842	815	701
Current grants	298	414	414	140	0	141	352	351	352	543	751	47	0	0	0	0
Capital grants	733	758	720	159	161	378	383	697	706	995	1,009	1,161	1,064	842	815	701
Total expenditure and lending minus repayments	6,135	6,898	6,585	1,692	1,483	3,929	3,251	6,059	6,142	8,329	8,440	9,847	11,213	12,432	13,768	15,072
of which: Social priority spending	355	410	365	72	72	205	205	333	333	555	555	800	1,050	1,197	1,410	1,520
Current expenditure	4,187	4,401	4,298	1,083	1,052	2,422	2,089	3,542	3,452	4,769	4,706	5,095	5,550	6,215	6,933	7,688
Wages and salaries	2,076	2,338	2,330	654	531	1,309	1,187	1,963	1,875	2,617	2,575	2,868	3,132	3,508	3,861	4,249
Interest payments	285	352	353	71	63	190	192	308	259	432	433	467	463	536	603	693
Foreign	70	106	105	15	13	67	72	83	91	145	146	155	178	225	283	355
Domestic	215	246	248	56	50	123	120	225	168	287	287	312	285	311	319	339
Other	1,749	1,424	1,404	353	184	831	504	1,150	1,115	1,593	1,571	1,660	1,845	2,048	2,334	2,597
Goods and services	282	365	349	68	26	203	92	294	294	452	392	500	598	748	912	1,041
Transfers and subsidies	1,467	1,058	1,055	285	158	628	412	856	821	1,141	1,179	1,160	1,246	1,300	1,422	1,556
of which: Air Madagascar	303	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
of which: JIRAMA	447	309	309	64	64	128	128	191	191	255	255	110	50	0	0	0
Treasury operations (net) [1]	77	287	211	5	274	93	205	121	204	127	127	100	111	123	135	149
Capital expenditure	1,948	2,497	2,287	609	430	1,507	1,163	2,517	2,691	3,560	3,734	4,753	5,663	6,217	6,835	7,383
Domestic financed	700	912	831	190	31	543	245	909	1,153	1,263	1,537	1,696	1,886	2,111	2,440	2,783
Foreign financed	1,248	1,586	1,456	420	399	964	918	1,608	1,538	2,297	2,197	3,057	3,777	4,106	4,395	4,600
Overall balance (commitment basis)	-863	-882	-614	-180	-11	-656	203	-840	-914	-1,144	-1,033	-2,260	-2,870	-3,469	-3,788	-4,080
Float (variation of accounts payable, + = increase)	259	55	-80	-65	-252	277	-160	45	144	-188	-83	-20	-20	0	0	0
Variation of domestic arrears (+ = increase)	-231	-225	-225	-28	-34	-106	-106	-121	-121	-145	-145	-48	-30	-30	-30	-30
Overall balance (including grants, cash basis)	-835	-1,051	-918	-272	-296	-486	-64	-915	-891	-1,477	-1,261	-2,327	-2,920	-3,499	-3,818	-4,110
Domestic primary balance (new program definition) [2]	...	-116	60	11	290	-22	577	29	-175	47	-163	56	305	331	395	502
Excluding Central Bank recapitalization						59	659	110	-94	128	-82					
Domestic primary balance (old program definition) [3]	240	...	...	...	...	...	...			...	...	...	...	...	...	...
Total financing	835	1,051	919	272	296	485	64	915	891	1,477	1,260	2,037	2,553	3,089	3,262	3,557
Foreign borrowing (residency principle)	502	764	675	197	184	481	432	741	688	1,052	961	1,848	2,310	2,746	2,849	3,070
External borrowing, Gross	751	999	911	260	238	586	535	911	855	1,302	1,211	2,182	2,712	3,264	3,580	3,900
Budget support loans	236	171	176	0	0	0	0	0	23	0	23	287	0	0	0	0
of which: Air Madagascar	0	133	133	0	0	0	0	0	0	0	0	0	0	0	0	0
Project loans	515	828	735	260	238	586	535	911	832	1,302	1,188	1,895	2,712	3,264	3,580	3,900
Amortization on a due basis (-)	-248	-236	-236	-64	-53	-105	-103	-170	-167	-250	-250	-333	-402	-518	-732	-830
Domestic borrowing (residency principle)	332	287	244	75	112	4	-368	174	203	425	299	189	243	343	414	488
Monetary sector	151	205	220	43	178	8	-294	154	239	357	347	103	145	218	263	326
Non-monetary sector	273	-67	-67	32	-44	-4	-75	20	-36	68	-48	86	98	124	150	162
Treasury correspondent accounts (net)	-97	137	78	0	-16	0	0	0	0	0	0	0	0	0	0	0
Excess financing [4]	0	0	0	0	0	0	0	0	0	0	0	-847	-1,522	-1,963	-2,503	-2,959
of which: budget support to be programmed	0	0	0	0	0	0	0	0	0	0	0	-290	-367	-411	-555	-552

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

[1]Domestic taxes include MGA 72 bn (0.2 percent of GDP) in 2017 corresponding to tax arrears of Air Madagascar used for its recapitalization, offset in the line Treasury operations (net).

[2] Primary balance excl. foreign-financed investment and grants. Commitment basis.

[3] Up to June 2018, primary balance excl. foreign-financed investment (but grants included). In 2017 adjusted for financial assistance to Air Madagascar (MGA 303 billion) and the shortfall of program grants (MGA 8

[4] A negative value indicates allocated financing with the disbursement schedule to be agreed.

Table 4. Madagascar: Fiscal Operations of the Central Government, 2016-24

(Percent of GDP)

	2016	2017	2018		2019		2020	2021	2022	2023	2024
	Actuals	Prel. Est.	EBS 19/13	Prel. Est.	EBS 19/13	Proj.	Projections				
Total revenue and grants	14.6	14.8	14.9	14.8	15.9	16.4	15.0	14.8	14.4	14.6	14.6
Total revenue	11.1	11.9	12.0	12.0	12.5	12.5	12.6	12.9	13.1	13.4	13.7
Tax revenue [1]	10.8	11.5	11.7	11.7	12.3	12.3	12.4	12.7	12.9	13.2	13.5
Domestic taxes	5.6	5.9	5.8	5.7	6.5	6.5	6.8	7.1	7.4	7.8	8.2
Taxes on international trade and transactions	5.2	5.7	5.9	5.9	5.7	5.7	5.6	5.6	5.4	5.4	5.3
Non-tax revenue	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	3.4	2.9	2.9	2.8	3.4	3.9	2.4	1.9	1.4	1.2	0.9
Current grants	0.7	0.8	1.0	1.0	1.2	1.7	0.1	0.0	0.0	0.0	0.0
Capital grants	2.7	2.1	1.9	1.8	2.2	2.2	2.3	1.9	1.4	1.2	0.9
Total expenditure and lending minus repayments	15.8	17.2	17.1	16.3	18.4	18.7	19.4	19.9	20.0	20.1	20.0
of which: Social priority spending	*0.8*	*1.0*	*1.0*	*0.9*	*1.2*	*1.2*	*1.6*	*1.9*	*1.9*	*2.1*	*2.0*
Current expenditure	10.7	11.7	10.9	10.7	10.5	10.4	10.1	9.9	10.0	10.1	10.2
Wages and salaries	5.6	5.8	5.8	5.8	5.8	5.7	5.7	5.6	5.7	5.7	5.7
Interest payments	0.9	0.8	0.9	0.9	1.0	1.0	0.9	0.8	0.9	0.9	0.9
Foreign	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.5
Domestic	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Other	3.7	4.9	3.5	3.5	3.5	3.5	3.3	3.3	3.3	3.4	3.5
Goods and services	0.6	0.8	0.9	0.9	1.0	0.9	1.0	1.1	1.2	1.3	1.4
Transfers and Subsidies	3.1	4.1	2.6	2.6	2.5	2.6	2.3	2.2	2.1	2.1	2.1
of which: Air Madagascar	*0.0*	*0.8*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
of which: JIRAMA	*0.9*	*1.2*	*0.8*	*0.8*	*0.6*	*0.6*	*0.2*	*0.1*	*0.0*	*0.0*	*0.0*
Treasury operations (net) [1]	0.6	0.2	0.7	0.5	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Capital expenditure	5.2	5.5	6.2	5.7	7.9	8.3	9.4	10.1	10.0	10.0	9.8
Domestic financed	1.2	2.0	2.3	2.1	2.8	3.4	3.3	3.4	3.4	3.6	3.7
Foreign financed	3.9	3.5	3.9	3.6	5.1	4.9	6.0	6.7	6.6	6.4	6.1
Overall balance (commitment basis)	-1.3	-2.4	-2.2	-1.5	-2.5	-2.3	-4.5	-5.1	-5.6	-5.5	-5.4
Float (variation of accounts payable, + = increase)	0.5	0.7	0.1	-0.2	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0
Variation of domestic arrears (+ = increase)	-1.2	-0.6	-0.6	-0.6	-0.3	-0.3	-0.1	-0.1	0.0	0.0	0.0
Overall balance (including grants, cash basis)	-2.0	-2.3	-2.6	-2.3	-3.3	-2.8	-4.6	-5.2	-5.6	-5.6	-5.5
Domestic primary balance (new program definition) [2]	…	…	-0.3	0.1	0.1	-0.4	0.1	0.5	0.5	0.6	0.7
Excluding Central Bank recapitalization					0.3	*-0.2*					
Total financing	2.0	2.3	2.6	2.3	3.3	2.8	4.0	4.5	5.0	4.8	4.7
Foreign borrowing (residency principle)	0.7	1.4	1.9	1.7	2.3	2.1	3.7	4.1	4.4	4.2	4.1
External borrowing, gross	1.4	2.1	2.5	2.3	2.9	2.7	4.3	4.8	5.3	5.2	5.2
Budget support loans	0.2	0.7	0.4	0.4	0.0	0.1	0.6	0.0	0.0	0.0	0.0
Project loans	1.2	1.4	2.1	1.8	2.9	2.6	3.7	4.8	5.3	5.2	5.2
Amortization on a due basis (-)	-0.7	-0.7	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.8	-1.1	-1.1
Domestic borrowing (residency principle)	1.3	0.9	0.7	0.6	0.9	0.7	0.4	0.4	0.6	0.6	0.6
Monetary sector	0.7	0.4	0.5	0.5	0.8	0.8	0.2	0.3	0.4	0.4	0.4
Non-monetary sector	0.9	0.8	-0.2	-0.2	0.2	-0.1	0.2	0.2	0.2	0.2	0.2
Treasury correspondent accounts (net)	-0.2	-0.3	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Excess financing [3]	0.0	0.0	0.0	0.0	0.0	0.0	-1.7	-2.7	-3.2	-3.7	-3.9
of which: budget support to be programmed	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*-0.6*	*-0.7*	*-0.7*	*-0.8*	*-0.7*

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

[1] Domestic taxes include MGA 90bn (0.3 percent of GDP) in 2016 and MGA 72 bn (0.2 percent of GDP) in 2017 corresponding to tax arrears of Air Madagascar used for its recapitalization, offset in the line Treasury operations (net).

[2] Primary balance excl. foreign-financed investment and grants. Commitment basis.

[3] A negative value indicates allocated financing with the disbursement schedule to be agreed.

Table 5. Madagascar: Balance of Payments, 2016-24

	2016	2017	2018		2019		2020	2021	2022	2023	2024
	Prel. Est.	Prel. Est.	EBS 19/13	Prel. Est.	EBS 19/13	Proj.	Projections				
					(Millions of SDRs)						
Current account	41.1	-40.1	22.8	68.9	-130.0	-172.3	-338.4	-443.4	-505.0	-565.8	-603.4
Goods and services	-162.7	-316.5	-367.8	-335.5	-505.5	-560.5	-617.9	-747.0	-843.9	-942.4	-1,020.1
Trade balance of goods	-190.0	-322.3	-333.3	-324.2	-469.5	-523.1	-617.6	-731.7	-834.1	-931.1	-997.6
Exports, f.o.b.	1,556.4	2,020.9	2,115.8	2,143.3	2,183.7	2,111.4	2,251.0	2,339.2	2,424.3	2,526.6	2,646.6
Of which: Mining	388.2	510.3	579.4	593.7	643.2	637.7	714.8	760.6	801.8	843.9	883.3
Of which: Vanilla	283.9	488.9	600.3	605.0	469.7	460.5	447.2	422.4	396.0	386.4	376.0
Imports, f.o.b.	-1,746.4	-2,343.2	-2,449.1	-2,467.4	-2,653.2	-2,634.6	-2,868.6	-3,070.9	-3,258.4	-3,457.7	-3,644.2
Of which: Petroleum products	-284.3	-343.5	-387.1	-387.1	-371.3	-413.1	-426.9	-427.8	-434.6	-453.1	-474.0
Of which: Food	-224.9	-398.8	-368.7	-373.3	-305.0	-325.4	-340.4	-345.5	-349.5	-353.7	-357.0
Of which: Intermediate goods and capital	-717.0	-924.2	-988.7	-997.5	-1,111.6	-1,131.6	-1,262.2	-1,390.6	-1,491.7	-1,597.5	-1,690.0
Services (net)	27.3	5.8	-34.5	-11.3	-36.0	-37.4	-0.3	-15.3	-9.8	-11.3	-22.5
Receipts	854.0	917.2	917.9	935.0	1,041.1	1,026.4	1,137.7	1,201.5	1,270.0	1,343.5	1,414.9
Payments	-826.7	-911.4	-952.4	-946.3	-1,077.1	-1,063.8	-1,138.0	-1,216.8	-1,279.7	-1,354.8	-1,437.4
Income (net)	-293.1	-255.3	-276.9	-281.5	-294.4	-220.6	-251.9	-256.5	-261.2	-266.3	-279.8
Receipts	24.3	27.3	35.8	39.1	41.8	43.8	50.4	54.2	62.3	71.7	82.5
Payments	-317.4	-282.7	-312.7	-320.5	-336.1	-264.4	-302.3	-310.7	-323.6	-338.0	-362.3
Of which: interest on public debt	-14.7	-16.1	-22.3	-22.3	-26.1	-29.0	-29.8	-32.9	-40.2	-48.8	-58.9
Current transfers (net)	496.9	531.6	667.6	685.8	669.9	640.8	531.4	560.2	600.1	642.9	696.5
Official transfers	100.3	105.7	123.3	125.7	153.7	197.0	55.8	50.4	53.8	57.4	61.3
Of which: Budget aid [1]	50.4	65.5	85.2	85.2	109.8	154.1	9.0	0.0	0.0	0.0	0.0
Of which: Other (net)	50.0	40.2	38.1	40.4	44.0	42.9	46.8	50.4	53.8	57.4	61.3
Private transfers	396.6	425.9	544.3	560.2	516.1	443.8	475.7	509.8	546.3	585.5	635.3
Capital and financial account	169.8	208.8	86.6	41.5	186.6	230.8	386.1	526.4	582.1	652.6	704.1
Capital account[1]	199.7	168.4	160.4	170.6	200.8	201.4	223.6	197.0	150.2	140.3	116.2
Of which: Project grant [1]	199.7	168.4	160.4	170.6	200.8	201.4	223.6	197.0	150.2	140.3	116.2
Financial account	-3.6	42.6	-34.5	-65.1	-14.1	29.5	162.5	329.4	431.9	512.3	587.9
Foreign direct and portfolio investment	324.2	258.1	337.4	350.7	239.4	285.5	290.3	328.1	346.9	366.8	387.8
Other investment	-327.9	-215.5	-372.0	-415.9	-253.6	-256.0	-127.8	1.3	85.0	145.5	200.1
Government	48.9	116.7	187.4	154.4	213.5	192.1	356.0	427.5	489.7	490.5	509.4
Drawing	99.3	174.1	237.5	204.5	262.6	242.0	420.2	502.0	582.1	616.4	647.1
Project drawings [1]	86.9	118.9	203.7	167.4	262.6	237.1	365.0	502.0	582.1	616.4	647.1
Budgetary support [1]	12.4	55.2	33.8	37.1	0.0	4.8	55.2	0.0	0.0	0.0	0.0
Amortization	-50.5	-57.4	-50.1	-50.1	-49.1	-49.8	-64.2	-74.5	-92.3	-126.0	-137.8
Private sector	-147.4	-98.1	-132.6	-131.6	-164.7	-172.2	-111.5	-103.3	-71.2	-56.3	-36.8
Banks	-5.1	1.8	-64.1	38.4	-56.3	2.6	0.0	0.0	0.0	0.0	0.0
Other (inc. unrepatriated export revenues)	-224.2	-235.9	-368.6	-483.0	-240.8	-273.4	-372.3	-322.8	-333.6	-288.7	-272.5
Errors and omissions	-26.3	-2.2	-39.2	-63.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	210.9	168.7	109.5	110.5	56.6	58.5	47.8	83.0	77.0	86.8	100.7
Financing	-210.9	-168.7	-109.5	-110.5	-56.6	-90.5	-103.6	-151.0	-150.2	-182.5	-192.4
Central bank (net; increase = –)	-210.9	-168.7	-109.5	-110.5	-56.6	-90.5	-103.6	-151.0	-150.2	-182.5	-192.4
Use of IMF credit (net)	20.8	83.5	16.0	24.4	91.2	59.9	-6.1	-12.2	-18.5	-37.2	-44.6
Other assets, net (increase = –) [2]	-231.7	-252.3	-125.5	-134.9	-147.9	-150.4	-97.5	-138.8	-131.7	-145.3	-147.7
Debt relief and cancellation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	32.0	55.9	68.0	73.2	95.6	91.6
					(Percent of GDP; unless otherwise indicated)						
Memorandum items:											
Grants	3.4	2.8	2.9	3.0	3.4	3.9	2.4	1.9	1.4	1.2	0.9
Loans	1.4	2.1	2.8	2.4	2.9	2.7	4.3	4.8	5.3	5.2	5.2
Direct investment	4.5	3.1	3.9	4.1	2.7	3.2	3.2	3.1	3.1	3.1	3.1
Current account											
Excluding net official transfers	-2.9	-3.3	-2.6	-2.2	-4.8	-5.8	-5.9	-6.1	-5.9	-6.0	-5.8
Including net official transfers	0.6	-0.5	0.3	0.8	-1.4	-1.9	-3.5	-4.3	-4.6	-4.8	-4.8
Debt service (percent of exports of goods)	5.9	12.6	7.8	7.9	20.0	20.2	19.5	19.2	19.2	19.5	18.7
Export of goods volume (percent change)	-32.8	-3.9	-5.0	-4.9	15.8	16.1	8.5	5.2	5.1	5.0	5.4
Import of goods volume (percent change)	17.9	13.5	-1.6	-0.2	12.4	6.3	7.3	7.7	6.6	6.4	5.7
Gross official reserves (millions of SDR)	834	1,086	1,221	1,221	1,369	1,372	1,469	1,608	1,740	1,885	2,033
Months of imports of goods and nonfactor services	3.9	4.0	4.3	4.3	4.4	4.5	4.4	4.5	4.6	4.7	4.8
Terms of Trade (estimated)	81.4	14.3	3.7	5.7	-7.5	-15.5	-3.1	-0.6	-0.9	-0.5	-0.3

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

[1] Includes official external financial support only with a disbursement schedule.

[2] Includes reserve accumulation.

Table 6. Madagascar: Monetary Accounts, 2016-24[1]

(Billions of Ariary; unless otherwise indicated)

	2016	2017	2018		2019		2020	2021	2022	2023	2024
	Actuals	Actuals	EBS 19/13	Prel. Estim.	EBS 19/13	Proj.			Projections		
Net foreign assets	3,587	4,417	4,927	4,927	5,519	5,654	6,456	7,537	8,665	10,068	11,648
Net foreign assets (BCM)	2,709	3,527	4,207	4,207	4,755	4,895	5,663	6,714	7,812	9,185	10,730
Net foreign assets (deposit money banks)	878	890	720	720	764	759	793	823	853	884	918
Net domestic assets	5,421	6,191	6,871	6,871	8,245	7,999	9,037	9,975	11,093	12,202	13,278
Domestic credit	6,174	7,001	7,935	7,935	9,456	9,500	10,393	11,410	12,273	13,135	14,125
Net credit to government	1,993	2,093	2,099	2,099	2,805	2,795	2,909	3,066	3,295	3,528	3,843
BCM	1,028	886	947	947	1,169	1,041	956	886	800	711	640
DMBs	644	938	1,096	1,096	1,231	1,350	1,536	1,752	2,057	2,367	2,741
Other credits	320	269	55	55	404	404	416	428	439	450	463
Credit to the economy	4,182	4,907	5,836	5,836	6,652	6,705	7,484	8,344	8,978	9,607	10,282
Credit to public enterprises	70	42	40	40	40	40	40	40	40	40	41
Credit to private sector	4,094	4,846	5,765	5,765	6,581	6,635	7,413	8,274	8,908	9,536	10,215
Other credits	18	19	31	31	31	31	31	31	31	31	26
Other items (net)	-754	-810	-1,064	-1,064	-1,211	-1,351	-1,356	-1,435	-1,180	-933	-847
BCM	305	406	215	269	118	223	253	203	203	203	203
Other	-1,059	-1,216	-1,332	-1,332	-1,329	-1,574	-1,608	-1,637	-1,383	-1,135	-1,050
Money and quasi-money (M3)	9,007	10,608	11,798	11,798	13,764	13,653	15,493	17,513	19,758	22,271	24,926
Foreign currency deposits	955	1,006	1,202	1,202	1,246	1,241	1,221	1,151	1,081	1,112	1,245
Short term obligations of commercial banks	45	51	60	60	51	51	51	51	51	51	51
Broad money (M2)	8,007	9,551	10,536	10,536	12,467	12,362	14,222	16,311	18,626	21,108	23,631
Currency in circulation	2,632	3,101	3,337	3,391	3,869	3,848	4,442	5,067	5,734	6,312	6,940
Demand deposits in local currency	2,847	3,506	3,688	3,687	4,592	4,549	5,153	5,952	6,874	7,892	8,929
Quasi-money including time deposits	2,528	2,943	3,458	3,458	4,007	3,965	4,627	5,292	6,018	6,903	7,761
			(Percentage change relative to broad money at beginning of the year)								
Net foreign assets	14.8	10.4	5.3	5.3	5.1	6.9	6.5	7.6	6.9	7.5	7.5
Net domestic assets	8.0	9.6	7.1	7.1	13.5	10.7	8.4	6.6	6.9	6.0	5.1
Domestic credit	9.3	10.3	9.8	9.8	14.5	14.9	7.2	6.8	5.7	4.9	5.0
Net credit to government	4.5	1.3	0.1	0.1	6.7	6.6	0.9	1.1	0.5	0.4	0.7
Credit to private sector	4.7	9.4	9.6	9.6	7.8	8.3	6.3	5.8	5.2	4.6	4.2
Other items (net; asset = +)	-1.3	-0.7	-3.2	-2.7	-0.4	-2.7	0.0	-0.2	1.2	1.0	0.1
					(Percentage change year-on-year)						
Broad money (M2)	21.3	19.3	10.3	10.3	18.4	17.3	15.0	14.7	14.2	13.3	12.0
Currency in circulation	24.4	17.8	7.6	9.4	15.9	13.5	15.4	14.1	13.2	10.1	9.9
Demand deposits in local currency	24.6	23.2	5.2	5.2	24.6	23.4	13.3	15.5	15.5	14.8	13.1
Quasi-money in local currency	14.9	16.4	17.5	17.5	16.0	14.7	16.7	14.4	13.7	14.7	12.4
Credit to the private sector (in nominal terms)	8.2	18.4	19.0	19.0	14.2	15.1	11.7	11.1	10.4	9.3	8.8
Credit to the private sector (in real terms)	1.2	9.4	12.9	12.9	7.2	8.7	5.7	5.7	5.4	4.3	3.8
Memorandum items:											
Money multiplier (M3/reserve money)	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.4	2.5	2.6
Velocity of money (GDP/end-of-period M3)	3.57	3.37	3.42	3.42	3.29	3.31	3.27	3.21	3.14	3.07	3.02

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

[1] End of period.

Table 7. Madagascar: Balance Sheet of the Central Bank, 2016-19[1]

(Billions of Ariary; unless otherwise indicated)

	2016	2017	2018					2019					
	Dec	Dec	March	June	Sep	Dec		March		June		Dec	
	Actuals	Actuals	Actuals	Actuals	Actuals	EBS 19/13	Actuals	EBS 19/13	Prel.Est.	EBS 19/13	Proj.	EBS 19/13	Proj.
Net foreign assets	2,709	3,527	3,544	3,577	3,583	4,207	4,207	4,315	4,222	4,326	4,580	4,755	4,895
Gross foreign assets	3,744	4,985	5,039	5,063	5,253	5,876	5,876	6,162	5,958	6,201	6,501	6,992	6,959
Gross foreign liabilities	-1,035	-1,458	-1,495	-1,487	-1,670	-1,669	-1,669	-1,847	-1,736	-1,875	-1,920	-2,237	-2,063
Net domestic assets	1,136	1,032	913	794	1,118	891	945	1,017	765	1,020	192	1,200	1,146
Credit to government (net)	1,028	886	885	845	949	947	947	961	732	850	253	1,169	1,041
Claims on central government	1,323	1,275	1,134	1,132	1,223	1,269	1,269	1,236	1,037	1,125	1,089	1,444	1,390
Statutory advances	298	174	84	84	98	212	212	180	0	87	0	261	255
Securitized debt (T-bonds and bills)	829	786	776	765	754	744	744	733	733	722	722	701	701
Discounted bills of exchange	78	39	0	0	78	17	17	27	0	20	0	105	0
On-lending of funds	117	275	273	282	292	295	295	295	303	295	301	295	311
Other credits	2	2	2	2	1	1	1	2	1	2	66	83	123
Government deposits	-295	-389	-250	-287	-274	-322	-321	-275	-305	-275	-837	-275	-349
Claims on other sectors	12	15	17	17	17	16	16	21	18	21	21	20	20
Claims on banks: Liquidity operations (+ = injection)	-210	-276	-465	-445	-133	-287	-287	-217	-245	-116	-380	-108	-137
Other items (net; asset +)	305	406	477	377	285	215	269	253	260	265	298	118	223
Reserve money	3,845	4,559	4,458	4,371	4,700	5,098	5,153	5,332	4,988	5,346	4,772	5,954	6,042
Currency in circulation	2,632	3,101	2,969	3,041	3,358	3,337	3,391	3,388	3,150	3,475	3,411	3,869	3,848
Bank reserves	1,212	1,457	1,488	1,329	1,342	1,507	1,507	1,689	1,575	1,616	1,104	1,830	1,927
Currency in banks	202	236	217	234	218	281	281	236	226	236	226	236	226
Deposits	1,009	1,221	1,271	1,095	1,124	1,226	1,226	1,453	1,349	1,380	878	1,594	1,701
Resident deposits	1	1	1	1	1	443	443	255	255	255	257	255	267
	(Cumulative annual flows, unless otherwise stated)												
Memorandum items:													
Net foreign assets	946	818	17	50	56	681	681	107	15	118	373	547	688
Millions of SDRs	207	165	-12	0	-24	106	106	9	-23	-2	35	57	91
Net domestic assets	-168	-104	-118	-238	86	-141	-87	127	-180	130	-753	309	201
Credit to government (net)	-21	-142	-1	-41	63	61	62	14	-215	-97	-695	222	93
Reserve money	778	714	-101	-188	142	540	594	234	-165	248	-380	856	889
Exchange Rate (MDG/SDR, end of period)	4,501	4,600	4,686	4,657	4,811		4,812		...		...		...
Net foreign assets (Millions of SDRs)	604	769	756	768	745	874	874	883	851	873	910	931	965

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

[1] End of period.

Table 8. Madagascar: Financial Soundness Indicators, 2009-18[1]

(Ratios, percent)

	2009 Dec	2010 Dec	2011 Dec	2012 Dec	2013 Dec	2014 Dec	2015 Dec	2016 Dec	2017 Dec	2018 Mar	2018 June	2018 Sep	2018 Dec
Capital Adequacy													
Regulatory capital to risk-weighted assets	15.6	15.5	16.0	16.2	15.1	14.0	13.8	13.6	13.2				12.7
Capital to assets	9.2	9.8	9.4	9.8	10.6	11.2	11.6	10.7	10.4	10.7	9.4	9.7	10.6
Regulatory Tier 1 capital to risk-weighted assets	16.2	16.1	17.0	16.9	16.0	14.6	14.8	14.1					12.6
Tier 1 to assets	7.8	8.2	7.9	8.1	8.6	8.5	8.7	8.0	7.5				7.2
Non-performing loans net of provisions to capital	25.0	25.3	26.0	22.0	25.6	20.9	19.5	16.5	15.5	16.9	16.6	17.5	15.8
Net open position in equities to capital	5.2	4.8	5.2	4.4	4.8	5.2	5.4	5.1	4.6	4.3	5.0	4.8	4.1
Asset Quality													
Non-performing loans to total gross loans	8.1	9.6	10.7	11.1	11.6	10.1	9.0	8.4	7.3	7.9	7.2	7.8	7.2
Earnings and Profitability													
Return on assets	2.2	2.1	2.4	2.6	3.0	4.2	4.6	3.9	4.4	4.5	4.6	4.4	4.4
Return on equity	22.5	21.2	24.5	26.2	30.0	38.9	41.5	35.9	41.9	43.2	45.2	43.4	43.1
Interest margin to gross income	58.1	59.3	59.2	60.5	60.9	56.5	55.0	60.5	62.0	63.6	62.5	61.9	61.1
Non-interest expenses to gross income	59.5	60.5	61.5	65.1	62.2	55.2	55.0	58.4	55.5	53.6	54.2	54.3	54.5
Trading income to total income	7.9	7.8	5.7	4.9	3.8	8.2	8.1	4.9	3.8	4.0	3.9	4.2	4.9
Personnel expenses to non-interest expenses	29.9	31.0	30.1	31.4	32.8	34.2	33.1	32.9	33.0	34.1	32.5	32.0	31.5
Liquidity													
Liquid assets to total assets (liquid asset ratio)	36.8	33.8	41.6	42.9	37.8	34.1	31.3	37.3	36.8	40.2	38.5	38.6	36.8
Liquid assets to short-term liabilities	56.0	50.7	60.4	64.0	56.4	51.5	46.9	54.6	53.4	59.7	55.6	58.8	54.8
Customer deposits to total (non-interbank) loans	163.8	164.5	164.9	177.7	150.4	144.7	137.4	145.6	146.3	144.6	144.2	151.6	139.6
Sensitivity to Market Risk													
Net open position in foreign exchange to capital	18.2	18.4	13.7	9.6	12.8	10.9	11.7	8.6	9.0	6.7	3.4	3.2	5.7
Spread between reference lending and deposit rates (basis point)	1,065	1,120	1,167	1,186	1,245	1,202	1,162	1,180	1,187	1,146	1,143	1144	1149
Foreign currency-denominated loans to total loans	20.8	23.6	20.5	20.7	16.1	15.6	15.8	12.8	15.0	12.2	11.9	11.79	12.12
Foreign currency-denominated liabilities to total liabilities	17.8	19.3	18.3	17.5	16.3	17.5	16.6	15.7	15.0	14.6	14.4	18.1	13.9

Source: Malagasy authorities.

[1] Ratios only concern banking sector.

Table 9a. Madagascar: Quantitative Performance Criteria and Indicative Targets, December 2018 and March 2019

(Billions of Ariary; unless otherwise indicated)	End-December 2018			End-March 2019		
	Performance Criteria	Estimation	Status	Indicative Targets	Estimation	Status
Fiscal						
Floor on primary balance excl. foreign-financed investment (commitment basis)[1]	22	60	Met	11	290*	Met
External						
Ceiling on accumulation of new external payment arrears (US$ millions)[2]	0	0	Met	0	0	Met
Ceiling on new external debt contracted or guaranteed by the central government or BFM, in present value terms (US$ millions)[4]	900	299	Met	900	370	Met
Central bank						
Floor on net foreign assets (NFA) of BFM (millions of SDRs) [5]	795	867	Met	844	845	Met
Ceilings on net domestic assets (NDA) of BFM [5]	1,423	1,301	Met	1,456	1,231	Met
Indicative targets						
Floor on social priority spending [1]	429	365	Not met	70	1*	Not met
Floor on gross tax revenue [1]	5,102	4,991	Not met	1,250	1,328	Met
Ceiling on new nonconcessional external debt with original maturity of more than one year, contracted or guaranteed by the central government or BFM (US$ millions)[3]						
Grant element of less than 35 percent	383	273	Met	383	273	
Grant element of less than 20 percent	100	95	Met	100	95	
Ceiling on new nonconcessional external debt with original maturity of up to and including one year, contracted or guaranteed by the central government or BFM (US$ millions)[2]	0	0	Met	0	0	Met
Memorandum items						
Official external program support (millions of SDRs) [3]	329	306		331	306	
Official external program grants (millions of SDRs) [1]	114	85		28	0	
Program exchange rate (MGA/SDR)	4,444	4,444		4,444	4,444	

Sources: Madagascar authorities; and IMF staff projections.

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

[2] Cumulative ceilings that will be monitored on a continuous basis starting from end-May, 2016.

[3] Cumulative ceilings that will be monitored on a continuous basis starting from January 1, 2016.

[4] Cumulative ceilings that will be monitored on a continuous basis starting from January 1, 2018.

[5] The total stock of NFA and NDA measured at the program exchange rates.

* The primary surplus of 0.6 percent of GDP in Q1 2019 and the non-execution of social priority spending are due to the fact that spending was temporarily almost exclusively limited to mandatory spending (wage bill, public pensions and debt service) in the context of the installation of the new government.

Table 9b. Madagascar: Quantitative Performance Criteria and Indicative Targets, June 2019

	2019
	End-June
	Performance Criteria
	(Billions of Ariary; unless otherwise indicated)
Fiscal	
Floor on primary balance excl. foreign-financed investment and grants (commitment basis) [1]	-22
External	
Ceiling on accumulation of new external payment arrears (US$ millions) [2]	0
Ceiling on new external debt contracted or guaranteed by the central government or BFM, in present value terms (US$ millions) [4]	900
Central bank	
Floor on net foreign assets (NFA) of BFM (millions of SDRs) [5]	833
Ceilings on net domestic assets (NDA) of BFM [5]	1,521
Indicative targets	
Floor on social priority spending [1]	198
Floor on gross tax revenue [1]	2,800
Ceiling on new nonconcessional external debt with original maturity of more than one year, contracted or guaranteed by the central government or BFM (US$ millions) [3]	
Grant element of less than 35 percent	383
Grant element of less than 20 percent	100
Ceiling on new nonconcessional external debt with original maturity of up to and including one year, contracted or guaranteed by the central government or BFM (US$ millions) [2]	0
Memorandum items	
Official external program support (millions of SDRs) [3]	331
Official external program grants (millions of SDRs) [1]	28
Program exchange rate (MGA/SDR)	4,444

Sources: Madagascar authorities; and IMF staff projections.

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

[2] Cumulative ceilings that will be monitored on a continuous basis starting from end-May, 2016.

[3] Cumulative ceilings that will be monitored on a continuous basis starting from January 1, 2016.

[4] Cumulative ceilings that will be monitored on a continuous basis starting from January 1, 2018.

[5] The total stock of NFA and NDA measured at the program exchange rates.

Table 10. Madagascar: Structural Benchmarks from December 2018 to end of the Arrangement

Action	Tentative Dates	Status
<u>Mobilizing fiscal revenue</u>		
Employ the new Tax Identification Number (TIN) throughout all ministries	End-Dec. 2018	**Not met**. Action completed in the major ministries.
Adopt a strategy for the control of high-risk sectors, such as free trade zones and new special economic and industrial zones	End-July 2019	
<u>Improving the composition and quality of fiscal spending</u>		
Adopt and implement an automatic fuel pricing formula with a smoothing mechanism by end-September 2018, while avoiding any budget costs from fuel pricing in the interim.	Continuous benchmark	**Met** at end-May 2019
<u>Enhancing economic governance</u>		
The terms and conditions of all PPP contracts will be published within one month of the date of signature on ARMP's web site.	Continuous benchmark	**Met.** No PPP contracts have been signed.
Notify World Bank and IMF staff of any single source procurement contracts for JIRAMA's purchases of electricity and purchases and rentals of generators.	Continuous benchmark	**Met.**
Start the process of publishing, including providing searchable internet access (using the criteria of topics and presiding judges), of all final court decisions by the anti-corruption centers.	End-Dec. 2018	**Met.**
Establish a public registry of companies that have violated the procurement regulations and are prohibited from participating in future bids.	End-Aug. 2019	
<u>Strengthening financial sector development</u>		
Submit to Parliament draft legislation to promote repo transactions.	End-Dec. 2018	**Met.**
Submit to Parliament a new banking law that will: (i) improve the bank recovery and resolution framework in line with FSSA recommendations; (ii) reinforce the framework for corrective bank supervisory measures (with the specific triggers, responsibilities, and time limits for an effective response to bank violations and vulnerabilities to be determined by the law or regulation); and (iii) enhance the powers and independence of the financial supervisor (CSBF), including legal protection for its staff and Board members.	End-Dec. 2018	**Not Met.** Further consultations with stakeholders in late 2018 before planned submission by end-July 2019.
Submit to Parliament a law on financial stability, in line with international standards and FSAP recommendations, establishing the structure in charge of analyzing, identifying, and preventing systemic risks as well as managing and addressing financial crises.	End-June 2019	**Not Met.** Should be submitted with a few weeks delay, after validation by the Business Law Reform Commission.

Table 11. Madagascar: External Financing Requirements and Sources, 2016-19

(Millions of U.S. Dollars)

	2016	2017	2018	2019
		Prel. Est.		Proj.
Total financing requirements	911	961	1,071	1,157
Current account deficit	-57	56	-98	240
Net repayment of private sector debt	205	136	186	239
Repayment of government debt	70	80	71	69
Gross reserves accumulation (+ = increase) [1]	325	350	191	209
IMF repayments	15	12	10	4
Other (inc. unrepatriated export revenues)	353	327	711	395
Available financing	911	961	1,071	1,112
Foreign direct and portfolio investment	452	358	496	408
Budget support loans	17	77	52	7
Project support	398	398	478	610
Project grants	278	234	241	280
Project drawings	121	165	237	330
IMF: RCF disbursement and ECF arrangement	44	128	44	87
Budget support to be programmed	0	0	0	45
Memorandum items:				
Gross official reserves [1]	1,159	1,506	1,728	1,907

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

[1] The change in gross official reserves can deviate from the gross reserves accumulation because of exchange rate movements.

Table 12. Madagascar: Projected External Borrowing, 2019

Public and publicly-guaranteed external debt contracted	Volume of new debt		PV of new debt (program purposes)	
	USD million	Percent	USD million	Percent
By sources of debt financing	1,001	100	595	100
Concessional debt, of which	*987*	*99*	*583*	*98*
Multilateral debt	474	47	249	42
Bilateral debt	506	51	330	55
Other	7	1	5	1
Non-concessional debt, of which	*14*	*1*	*12*	*2*
Grant element between 0 and 35 percent	10	1	7	1
Commercial terms	4	0	4	1
By Creditor Type	1,001	100	595	100
Multilateral	484	48	256	43
Bilateral - Paris Club	14	1	8	1
Bilateral - Non-Paris Club	496	50	326	55
Other	7	1	5	1
Uses of debt financing	1,001	100	595	100
Infrastructure	849	85	520	87
Social Spending	60	6	28	5
Budget Financing	61	6	30	5
Other[1]	31	3	16	3

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

[1]Includes Agriculture and Financial Sector Development.

Table 13. Madagascar: Proposed Schedule of Disbursements and Timing of ECF Arrangement Reviews

Availability Date	Disbursement (In percent of quota)	Disbursement (In SDRs)	Conditions for Disbursement
July 27, 2016	12.9	31,428,000	Board approval of the arrangement
June 28, 2017	25.4	61,978,000	Board completion of first review based on observance of performance criteria for end-
November 20, 2017	12.9	31,428,000	Board completion of second review based on observance of performance criteria for end-June 2017
May 20, 2018	12.9	31,428,000	Board completion of third review based on observance of performance criteria for end-December 2017
November 20, 2018	12.9	31,428,000	Board completion of fourth review based on observance of performance criteria for end-June 2018
May 20, 2019	12.9	31,428,000	Board completion of fifth review based on observance of performance criteria for end-December 2018
November 20, 2019	12.9	31,432,000	Board completion of sixth review based on observance of performance criteria for end-June 2019
Total	102.5	250,550,000	

Source: IMF.

Table 14. Madagascar: Indicators of Capacity to Repay the Fund, 2019-32

(As at July 1st, 2019)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
						(Millions of SDRs)								
Fund obligations based on existing credit														
Principal	3.1	6.1	12.2	18.5	37.2	43.6	43.7	37.5	31.3	12.6	3.1	0.0	0.0	0.0
Charges and interest	0.7	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Fund obligations based on existing and prospective credit														
Principal	3.1	6.1	12.2	18.5	37.2	43.6	56.2	50.1	43.8	25.1	15.7	0.0	0.0	0.0
Charges and interest	0.7	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Total obligations based on existing and prospective credit														
Millions of SDRs	3.7	7.4	13.5	19.8	38.5	44.8	57.5	51.4	45.1	26.4	17.0	1.3	1.3	1.3
Billions of Ariary	18.6	38.4	72.9	111.0	223.4	270.2	354.0	323.1	289.7	173.3	113.9	8.8	8.9	9.1
Percent of exports of goods and services	0.1	0.2	0.4	0.5	1.0	1.1	1.3	1.1	0.9	0.5	0.3	0.0	0.0	0.0
Percent of debt service	2.7	4.8	8.4	10.5	16.7	17.7	20.1	16.5	13.0	7.3	4.3	0.3	0.3	0.2
Percent of GDP	0.0	0.1	0.1	0.2	0.3	0.4	0.4	0.4	0.3	0.2	0.1	0.0	0.0	0.0
Percent of government revenue	0.3	0.6	1.0	1.4	2.4	2.6	3.0	2.5	2.0	1.1	0.6	0.0	0.0	0.0
Percent of quota	1.5	3.0	5.5	8.1	15.7	18.3	23.5	21.0	18.5	10.8	7.0	0.5	0.5	0.5
Outstanding IMF credit based on existing and prospective drawings														
Millions of SDRs	308.6	302.5	290.3	271.7	234.6	191.0	134.8	84.7	40.8	15.7	0.0	0.0	0.0	0.0
Billions of Ariary	1,546.0	1,570.6	1,568.5	1,523.8	1,362.4	1,151.1	829.7	532.4	262.4	103.1	0.0	0.0	0.0	0.0
Percent of exports of goods and services	9.8	8.9	8.2	7.4	6.1	4.7	3.1	1.9	0.8	0.3	0.0	0.0	0.0	0.0
Percent of debt service	226.5	196.2	181.3	144.6	102.1	75.5	47.2	27.1	11.8	4.3	0.0	0.0	0.0	0.0
Percent of GDP	3.4	3.1	2.8	2.5	2.0	1.5	1.0	0.6	0.3	0.1	0.0	0.0	0.0	0.0
Percent of government revenue	27.4	24.6	21.6	18.8	14.9	11.2	7.1	4.1	1.8	0.7	0.0	0.0	0.0	0.0
Percent of quota	126.3	123.8	118.8	111.2	96.0	78.1	55.1	34.6	16.7	6.4	0.0	0.0	0.0	0.0
Net use of IMF credit (millions of SDRs)	91.2	-6.1	-12.2	-18.5	-37.2	-43.6	-56.2	-50.1	-43.8	-25.1	-15.7	0.0	0.0	0.0
Disbursements	94.3	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
Repayments and repurchases	3.1	6.1	12.2	18.5	37.2	43.6	56.2	50.1	43.8	25.1	15.7	0.0	0.0	0.0
Memorandum items:						(Billions of Ariary, unless otherwise indicated)								
Exports of goods and services (millions of SDRs)	3,138	3,389	3,541	3,694	3,870	4,061	4,302	4,557	4,832	5,123	5,432	5,760	6,108	6,482
Debt service	682.4	800.4	865.1	1,053.8	1,334.4	1,523.6	1,756.8	1,962.8	2,228.1	2,386.3	2,674.2	3,075.3	3,542.0	3,997.4
Nominal GDP (at market prices)	45,247	50,628	56,295	62,085	68,343	75,209	82,736	90,987	100,073	109,939	120,727	132,558	145,495	159,680
Government revenue	5,647	6,379	7,278	8,120	9,165	10,291	11,633	12,892	14,299	15,841	17,516	19,365	21,401	23,679
Quota (millions of SDRs)	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4

Source: IMF staff estimates and projections.

Annex I. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Potential Impact	Policy response
		Domestic Risks	
Weak investment implementation capacity.	**High**	**High**: Slower economic growth.	Monitor available domestic capacity (particularly in construction) and give precedence to priority investment with highest returns.
Larger than anticipated transfers to SOEs (e.g. JIRAMA).	**Medium**	**Medium**: Transfers to SOEs reduce other priority expenditure. Potential economic disruption if SOEs' operations are affected.	Identify options to protect key public services. Encourage authorities and development partners to protect social priority spending. Strengthen governance structures, including government oversight of key SOEs. Consider private management of specific units or operations.
Political uncertainty and social tensions.	**Medium**	**High**: Reduced inflows from FDI, donor support, and tourism. Less fiscal space impedes the ability to deliver public services.	Maintain exchange rate flexibility and reallocate fiscal spending from investment to support of the most vulnerable. Encourage authorities and development partners to protect social priority spending.
Failure to tackle corruption.	**High**	**Medium**: Reduced inflow of FDI and donor support.	Step-up anti-corruption and AML/CFT efforts. See response above.
Cyclones, floods, and droughts.	**Medium**	**Medium**: Loss of real and human capital and lower growth.	Reallocate fiscal spending to finance recovery work and make appeal to donors for post-disaster financing.
		External Risks	
Weaker-than-expected global growth.	**Medium (U.S, China), High (Europe)**	**Medium**: Slower growth in tourism (especially from Europe) and lower commodity prices (especially from sluggish China demand) weaken the balance of payments.	Maintain exchange rate flexibility as a shock absorber. Diversify sources of tourism.
Rising protectionism and retreat from multilateralism.	**High**	Medium: Reduced inflows from FDI and donor support. Reduced access to foreign markets.	Maintain exchange rate flexibility and reallocate fiscal spending from investment to key public services and support of the most vulnerable. Energize donor support by emphasizing the merits of the medium-term development plan.
Large swings in energy prices.	**Medium**	Medium: Higher energy prices weaken the balance of payments, raise inflation, and make fuel and electricity reforms harder.	Continue the reform of JIRAMA. and implement an agreement with fuel distributers and an automatic fuel price formula in the future, while social spending and differentiation across fuel types shelter the most vulnerable.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of the IMF staff. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex II. Towards an Automatic Fuel Pricing Mechanism and Mitigation Measures for the Poorest[1]

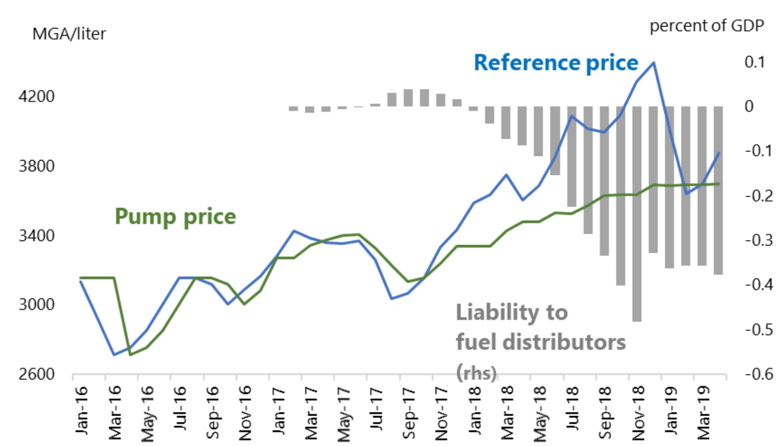
An effort to align fuel prices with market prices started in mid-2014 and worked successfully in 2016 and 2017. However, since 2018, renewed difficulties in adjusting pump prices led to additional fiscal costs. A plan towards establishing an automatic price mechanism and settlement of the existing liability was agreed in February 2019 and scheduled to be implemented by September 1, 2019. While this mechanism would avoid budgetary impact from fuel pricing in the future, provisions need to be made for mitigation measures for the poorest households, including through the development of social safety nets.

A. Background on Direct or Implicit Fuel Subsidies

1. **Madagascar initiated the process of removing fuel subsidies in the favorable context of the fall in international oil price in 2014-15**. Gradual increases of pump prices took place starting July 2014, and the government instituted a price adjustment mechanism in February 2016. This new scheme worked satisfactorily in 2016 and 2017 (Text Figure 1). Pump prices were adjusted regularly, and any liability to the oil distributors in case of temporary gap between the pump prices and the reference prices was settled through further increases in pump prices in following months, avoiding any budget cost.

2. **However, this favorable situation reversed in 2018**. Despite ad hoc adjustments in pump prices totaling 10 percent in 2018, the gap between reference and pump prices led to a cumulative liability to fuel distributors equivalent to 0.5 percent of GDP in November 2018, before being reduced in December through cross-cancellation of payments due by the distributors to the Road Maintenance Fund.

Text Figure 1: Oil Prices and Liability to Oil Companies



Sources: Malagasy authorities; and IMF staff estimates.

3. **The situation continues to be complicated in 2019 despite a short respite at the beginning of the year**. After peaking at 16 percent in December, the gap has dropped to 8 percent in January and disappeared in February, due to the fall in international oil prices late in 2018 (reflected with a two month-delay in the reference price formula). Although there was no increase in early 2019, the pump

[1] Based on IMF Staff analysis and the World Bank Note "Madagascar Economic Update: Managing Fuel Pricing", Spring 2019.

price was even slightly above the reference price in February 2019. However, this relief was short-lived given the volatility of international oil prices, underscoring the importance of implementing a new fuel pricing policy.

B. Towards an Automatic Price Mechanism

4. **On February 28, 2019, a memorandum of understanding (MoU) was signed with the fuel distributors on plans for an automatic fuel price mechanism and settlement of the existing liability**. This memorandum was signed by the minister of energy, water and hydrocarbons, and the managing directors of six fuel distributor companies in Madagascar. It specified the timetable and modalities of negotiations for the application of a new price structure by June 2019, the implementation of a fuel price mechanism starting in September 2019, and the settlement of the existing liabilities from the government to the fuel distributors.

5. **On June 19, 2019, an agreement was reached for the implementation of a new price structure**. This new structure reduces the margins of the distributors by the equivalent of 12 percent. Part of this reduction was immediately used by the government to lower pump prices: on June 20, the price of gasoline (used for individual cars) was lowered by 2.4 percent; the price of diesel (mostly used by transporters by 4.2 percent; and the price of kerosene (used by the poorest households) by a larger margin (19 percent). With kerosene accounting for less than 5 percent of fuel consumption, the pump price reduction is equivalent to about 4.5 percent on average. The remainder of the reduction in distributor margins, applied retroactively from January 2019, reduced significantly the liability to oil distributors, which is estimated at less than MGA 110 bn (0.2 percent of GDP) at end-June 2019, below the limit agreed in the February MoU. Furthermore, with current parameters (notably international oil price and exchange rate), the gap between reference price and pump price is estimated to be small in August, paving the way for the implementation of an automatic mechanism starting September.

6. **The plan includes the establishment of a new pricing mechanism (to be implemented in September 2019) to avoid any lasting significant liability**. The mechanism combines two elements: an automatic price calculation with a smoothing formula, along with a limited discretionary adjustment, which could help manage potentially difficult social impacts. The smoothing formula could lead to some limited, transparent and predictable accumulation of liabilities—in either direction depending on price movements—between the government and distributors; both parties agree to accept this accumulation. The discretionary adjustments will be applied to changes dictated by the mechanism, and their scope is limited by an agreement between the government and the distributors in terms of a cap on the accumulated resulting liability (not to exceed MGA 50 billion, slightly more than 0.1 percent of GDP).

7. **The existing liability will be progressively settled**. Concerning the existing accumulated liability to the distributors, MGA 100 billion was settled in December 2018 through the cancellation of payments due by fuel distributors to the Road Maintenance Fund. The remainder will be settled steadily by end-2020, through the gap between pump and reference price if favorable to the government or potentially through an additional element in the pump price structure to be applied temporarily, in agreement with the distributors. While not the option favored by the government, a one-of transfer in the 2020 budget is not excluded.

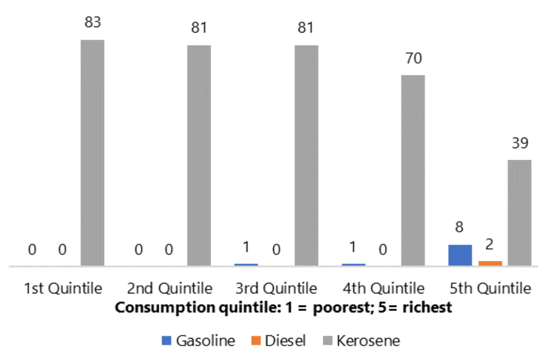
8. The overall objective of this mechanism is to avoid budgetary impact from fuel pricing in the future by following cost recovery pricing ("vérité des prix"), limit monthly price movements and maintain some flexibility—within limits—to deal with the social impact. The continuing application of this mechanism, including interim pricing arrangements until September, is a continuous structural benchmark under the current ECF arrangement. At end-May 2019 and even before the implementation of the new reference price formula, this conditionality was met, the accumulated liability of MGA 168 billion being lower than the ceiling in the agreement (see details on the ceiling in the Technical Memorandum of Understanding for the 4th review, ¶25). As discussed in paragraph 5, the enforcement of the new price structure reduced significantly the liability to oil distributors.

C. Mitigation Measures for the Poorest

9. A fuel pricing policy should aim to protect the poor from price increases and promote affordability of this key commodity. While the poorest 40 percent of the population do not consume gasoline and diesel, they do consume kerosene for lighting and other services (Text Figure 2). Furthermore, the poorer households also spend a higher share of their overall budget on food, which uses fuel as an input. The recent agreement leading to a reduction of the price of kerosene by almost 20 percent is then welcomed.

Text Figure 2: Households consuming fuel products

(by quintile, in percentage)



Sources: Malagasy authorities; and World Bank.

10. Fuel price subsidies do not generally reach those people most in need and could advantageously be replaced by more cost-effective and well targeted social safety nets. In Madagascar, the mitigating measure that has been used to cushion the effects of higher and volatile fuel prices is the subsidy for urban transport companies, but this is not targeted to the poor. This is because 91 percent of Madagascar's poor live in rural areas, and are therefore excluded from this transport subsidy, and even within urban areas the poor make limited use of public transport. In addition, global experience shows that public transport subsidy schemes transferred as cash to bus companies are inefficient. In Madagascar, there is no consolidated register of urban transport companies, and the management of the transport subsidy is not supported by effective control measures. In the end, this mitigating measure may contribute to alleviating the concerns of the urban lower-middle classes but leaves the poorest households behind.

11. A strategy to cushion the effect of price increases on the poor, and more broadly to fight against poverty, is to strengthen the social safety nets already in place. The World Bank is supporting the Human Development Cash Transfer (HDCT) program, a conditional cash transfer program providing regular cash benefits for families with children 0-12 years. It is linked to primary schooling, and good practices for health, nutrition and early childhood development. Madagascar's

Productive Safety Net program (PSNP) provides cash for work opportunities over three years. It moves beyond the short-term interventions by incentivizing beneficiaries to make productive and long-term investments. In total, about 150,000 households (approx. 750,000 people or 3 percent of the population) have benefitted so far from these safety net programs, with more than 70 percent of cash transfers being paid to the female head of the household. The scaling-up of these programs is ongoing but depends on the capacity to reach the most vulnerable.

Appendix I. Republic of Madagascar: Letter of Intent

Antananarivo, Madagascar

July 10, 2019

Mr. David Lipton
Acting Managing Director
International Monetary Fund
Washington, D.C. 20431 USA

Dear Mister Acting Managing Director:

1. The attached Memorandum of Economic and Financial Policies (MEFP) reviews recent economic developments and performance under the Extended Credit Facility (ECF) arrangement. It also updates the government's policies and objectives for the rest of 2019. These policies are in line with the General Policy Program of the State (*Politique Générale de l'État*) presented to Parliament on February 4th, 2019.

2. The Republic of Madagascar is continuing to make good progress in strengthening macroeconomic stability, promoting inclusive and sustainable growth, and reducing poverty. Economic growth has accelerated in the past year, and inflation remains under control. After the smooth electoral period and transfer of power, the government has laid the foundation for the implementation of the ambitious reform agenda announced by the President, aimed at further strengthening the macro-economic prospects, including by accelerating economic growth, driven by rising private sector activity and the ongoing scaling up of public investment. The Government also attaches the utmost importance to security, the social situation, and the fight against poverty. Our external sustainability remains sound and, based on an updated debt sustainability assessment, the risk of overall public debt distress remains moderate.

3. Notwithstanding this momentum, Madagascar faces persistent and significant challenges. In particular, we aim to make further headway in raising living standards and reducing poverty by promoting inclusive growth. The key fiscal priorities are increasing spending on public investment and social needs, containing the level of lower priority spending, and enhancing revenue mobilization. In addition, reforms are continuing to build a sound and inclusive financial sector, as well as continuing progress in economic governance, especially the fight against corruption. As a low-income fragile country, Madagascar remains highly vulnerable to external and internal shocks. Against this background, continued financial and technical support from the IMF remains essential, including to help catalyze financial support of donors.

4. As documented in the attached MEFP, we have met all the end-December 2018 performance criteria, including the one on domestic primary balance, despite a shortfall in tax revenue in the second half of 2018. Our structural reform agenda is advancing. Of the six structural benchmarks for

2018, three were fully achieved and we made significant progress on all others. Two of the three continuous benchmarks were also met. The third one, on avoiding budget costs from fuel pricing, was not achieved in late 2018, but has been respected since the benchmark's revision at the time of the fourth review to reflect the new government plan on fuel pricing. Significant progress on this plan was achieved in June with the implementation of a revised fuel price structure.

5. The attached MEFP describes government policies for the rest of 2019 that support achieving program objectives under the ECF arrangement. We stand ready to take any further measures that may prove necessary to meet our objectives and will consult with IMF staff prior to the adoption of any changes to the policies set forth in the Memorandum. The new measures or policies will be implemented in such a way so as to not deteriorate Madagascar's balance of payments. We are committed to provide timely monitoring information.

6. In light of the performance on end-December 2018 targets and continuing progress in implementing the program, we request the IMF Executive Board to approve the completion of the fifth review. In this context, at the fifth review we are seeking total financial support from the Fund equivalent to 12.9 percent of our quota, or SDR 31.4 million.

7. The ambitious economic reform agenda proposed by the President is consistent with the main objectives of the ECF-supported program. The priorities detailed in the Madagascar Emergence Initiative (Initiative Emergence Madagascar, IEM), that have been integrated in the General Policy Program of the State (*Politique Générale de l'Etat*, PGE), are consistent with the main objectives of the ECF-supported program. These priorities which will be formalized in the *Plan Emergence Madagascar* include strategies for (i) higher and sustained economic growth, based on the mobilization of tax revenues and the prioritization of spending, particularly towards investment; (ii) more inclusion, supported by strengthened social policies and spending, with the objective of reducing poverty and a better access to education, health, and housing; and (iii) better governance and institutions.

8. The Malagasy authorities agree to the publication of this Letter of Intent (LOI) and the attached MEFP and Technical Memorandum of Understanding (TMU), as well as the IMF staff report related to the arrangement under the ECF, after approval by the Executive Board of the IMF.

Sincerely yours,

/s/	/s/
Mr. Fanomezantsoa Lucien RANARIVELO Acting Minister of Economy and Finance Minister of Agriculture, Livestock and Fisheries Madagascar	Mr. Alain Hervé Rasolofondraibe Governor Central Bank of Madagascar

Attachments:

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

Attachment I. Memorandum of Economic and Financial Policies

This Memorandum of Economic and Financial Policies (MEFP) updates the one outlined for the completion of the fourth review approved by the IMF Executive Board on March 22, 2019. It describes recent economic developments, implementation of the ECF-supported program, the economic outlook and risks, and macroeconomic policies.

I. RECENT ECONOMIC DEVELOPMENTS

1. After exceeding 5 percent in 2018, economic growth is expected to remain strong in 2019. Preliminary estimates suggest that real GDP growth accelerated to 5.2 percent in 2018—the best performance in the last ten years—partly explained by a recovery in agriculture (which accounts for one quarter of total GDP), especially rice production. Other favorable factors in 2018 were a strong private sector activity (notably construction), the scaling up of public investment, and the growing demand for transport and other services. Despite the budget under-execution and limited disbursement of foreign-financed projects, we have increased investment spending for the year in the revised budget law (see ¶14) accompanied by measures to streamline execution without compromising oversight. There was a slight reduction in private companies' turnover in the first three months of the year, but surveys suggest rising confidence. There are also indications of increased imports for some items (e.g. primary materials). Together with the smooth electoral process, inauguration of the president, and the formation of the government, we expect economic growth to continue at a rate of about 5 percent in 2019.

2. At the same time, inflation has remained under control. Consumer price inflation gradually declined to 6.1 percent year-on-year (y-o-y) in December 2018 after peaking to 9.1 percent year-on-year in November 2017. During the same period, core inflation (excluding rice and energy) declined from 7.4 to 6.4 percent y-o-y. Inflation continued to fall during the first three months of 2019 and is currently slightly above 6 percent.

3. Despite the electoral year, budget execution and fiscal performance were satisfactory in 2018, with limited slippages compared to the revised budget law.

- Total net tax revenue reached 11.7 percent of GDP in 2018, below the 12.0 percent of GDP targeted in the supplementary budget, but still slightly increased compared to 2017 (11.5 percent of GDP). Domestic tax revenue collection fell short of targets in the second half of 2018, notably explained by the impact of strikes in the tax administration and a significant increase in deductible VAT, but it was partly offset by custom revenue that continued to overperform. In total, this performance represents an increase of 1.8 percentage point of GDP in three years, reaching the highest level relative to GDP since 2008. Non-tax revenue performance was good, reaching 0.3 percent of GDP mainly as a result of strong dividends from companies in which the government has shareholdings.

- Spending was also broadly in line with the supplementary budget, with some limited savings late in the year to compensate for the slight shortfall in revenue. The transfers to JIRAMA were limited to budgeted amounts (MGA 309 billion, or 0.8 percent of GDP). Commitments for domestically financed investment were limited to 84 percent of the amount planned under the program. The execution rate of externally financed investment has improved, although, at 3.6 percent of GDP, it was below the amount initially envisaged. Finally, priority social spending, at 0.9 percent of GDP, fell short of its initial target (see ¶8).

4. **Fiscal developments in the first months of 2019 included encouraging revenue performance, under-execution in spending, and less pressure on the financing of the budget**. Fiscal revenue exceeded targets by the equivalent of about 0.1 percent of GDP in the first five months of 2019, thanks to continuing good performance in customs, a rebound in domestic tax collection since February—particularly for income and corporation taxes—and arrears recovery. Due to the installation of the government and the reorganization in the ministries, spending was limited, and directed mainly to mandatory spending (debt service, wages and pensions payments). We expect that the recent adoption of the 2019 Revised Budget Law (see ¶14) will allow for a quick normalization of spending, which has been under-executed in the first five months of the year. With higher than anticipated fiscal revenue and budget under-execution, the primary domestic balance has been positive, estimated at about 0.6 percent of GDP in the first quarter of 2019. At the same time, the financing of the budget has been eased by favorable Treasury bill issuances (after some difficulties in 2018) and the disbursement in June of a $100 million World Bank budget grant (more than doubling the amount initially planned). We took advantage of this opportunity to repay all Central Bank statutory advances (0.5 percent of GDP at end-2018) and accumulate deposits for the equivalent of more than 0.4 percent of GDP between end-2018 and end-May 2019.

5. **External developments have remained positive**. A strong export performance underpinned by continued high vanilla and mining receipts helped the current account balance improve to an estimated surplus of around 1 percent of GDP in 2018, compared to a deficit of 0.5 percent of GDP in 2017, despite higher oil, investment and consumption-related imports. External financing continues to rely on concessional borrowing and our capacity to carry debt is improving.

6. **The central bank (BFM) continues to reduce exchange rate volatility and support gradual accumulation of reserves**. Reserves increased to SDR 1221 million in 2018, resulting in an import coverage of 4.3 months. Reserves have remained stable so far in 2019, reaching SDR 1224 million in May 2019. In the context of the flexible exchange rate regime, the BFM has continued following the algorithm developed with Fund technical assistance (TA) to reduce volatility and support gradual accumulation of reserves. Overall, at end-2018, the nominal effective exchange rate (NEER) depreciated by an estimated 3.6 percent year-on-year, and the real effective exchange rate (REER) remained stable (+0.7%) reflecting higher inflation in Madagascar compared to its trading partners.

7. **Despite volatile conditions, the BFM has successfully managed inflation and bank liquidity**. Inflation has continued its downward path, as described above. Bank reserves are usually both cyclical and volatile in Madagascar, notably impacted by the cycle of vanilla, exacerbated in recent years by historically high prices. While banks lose liquidity when they provide currency to vanilla farmers who keep much of their savings in cash, they gain liquidity when they sell foreign exchange (mainly related to vanilla exports) to the BFM. Despite the ensuing swings in bank liquidity

in 2018 (as in previous years), the BFM's management of this liquidity has led to developments in monetary aggregates in line with the objectives of growth and inflation. Money supply growth was 11.9 percent y-o-y in March 2019; credit to the private sector growth was 17.8 percent and deemed consistent with macroeconomic stability and financial sector soundness.

II. PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM

8. Performance on the program's quantitative targets at end-December 2018 was strong, with all performance criteria (PC) met:

- The indicative target (IT) on tax revenue was missed by the equivalent of 0.2 percent of GDP, the result of the already described temporary shortfall in domestic tax revenue collection—the annual target was missed by about 7 percent—only partially compensated by customs over-performance by 5 percent compared to target. Due to some shortfall in primary spending, notably on investment late in the year, the domestic primary balance recorded a slight surplus (equivalent to 0.1 percent of GDP), and the PC was met.

- However, the indicative target on domestically financed priority social spending was missed, due to lower capital spending, part of which is included in the definition of the target. Limited to about 0.05 percent of GDP during the first three quarters of 2018, the shortfall worsened in the last quarter, to reach 0.16 percent of GDP for the entire year. This shortfall was largely due to difficulties in implementing planned domestically financed investments in the Ministry of Education (execution rate of only 56 percent).

- Regarding the central bank, the floor on net foreign assets and the ceiling on net domestic assets have been met, both with substantial margins.

- The performance criteria of zero accumulation of new external payment arrears and on the present value of external debt contracted were respected. Indicative targets for ceilings on new long-term non-concessional external debt as well as for short-term debt, were also respected.

9. Based on preliminary indications, we are on track to observe all quantitative performance criteria for end-June 2019, the last test date of the ECF arrangement. With encouraging revenue performance in the first months of the year, we are confident that we will meet the domestic primary balance target, the fiscal anchor of the program. Other PCs for end-June 2019 are also within reach. Finally, notwithstanding the under-execution of spending in the first part of the year, which negatively affected social spending commitments, the government is committed to further prioritizing social spending, and has increased allocation to social sectors in the recently adopted 2019 revised budget (see ¶14).

10. Progress in the implementation of the structural reform agenda also continued, although with some delays in the second half of 2018 mainly related to the electoral period:

- We have observed the two continuous SBs on governance related to transparency in PPPs and JIRAMA's procurement activity.

- We achieved progress on all SBs for end-December, fully observing two of the four. The draft legislation to promote repo transactions was submitted to the Parliament in December 2018, observing the SB; this law remains to be adopted by Parliament. The process for publication of all final court decisions by the anti-corruption courts is completed. However, given the need for additional work and consultation, it was not possible to submit the draft banking law to Parliament as initially planned; the draft is now ready and will be submitted to Parliament in July 2019. The new Tax Identification Number (TIN) is now in use in all the directorates of the Ministry of Economy and Finance, at the Ministry of Trade, and at CNAPS, so we did not fully observe this SB.

- Despite several increases in pump prices in 2018 (totaling 10 percent) and given the fragile environment, we did not observe the SB on avoiding budget costs from fuel pricing. That said, the SB was modified at the time of the fourth review, to take into account the Memorandum of Understanding signed by the government and the oil distributors in February 2019, which aims at maintaining cost-recovery pricing (and therefore avoiding future budget costs of fuel pricing), while keeping in mind the country's social fragility. This revised SB has been respected so far.

III. ECONOMIC OUTLOOK AND RISKS

11. The macroeconomic outlook continues to be favorable. We have a pro-active approach, with the objective of increasing real GDP growth to above 5 percent per year or more starting in 2020, above the more conservative assumption of about 5 percent per year currently set in our macro-framework for the next three years. We consider growth of or above 6 percent attainable based on improving the quality and quantity of public investment in infrastructure, despite recent under-execution, and increasing private sector activity, especially tourism, light manufacturing, mining, and agriculture. We will focus on gradually enhancing the productivity of smallholder agriculture and developing export-oriented agribusiness to support inclusive growth. We are also confident in our ability to contain inflation within single digits and towards a long-term objective of about 5 percent per year.

12. Nonetheless, we are aware of the vulnerabilities faced by Madagascar, as a low-income country with an open economy and continuing weaknesses in institutions. The country remains highly vulnerable to natural disasters (cyclones and droughts), and terms of trade shocks, particularly from oil, metal and vanilla prices. In addition, growth could remain below our expectations if implementation of public infrastructure investment continues to be slower than expected. The government continues to work in the identification, monitoring and, where possible, the mitigation of fiscal risks, including those related to state-owned enterprises (SOEs), especially JIRAMA, or to the deficit of the civil pension fund.

13. We believe that there are also upside risks, particularly for growth. We are convinced that our efforts to accelerate the scaling-up of public investment will bear fruit, consistent with our objective of a growth rate of at least 6 percent per year in the medium term. In addition, current projections for private investment, including foreign direct investment, could prove to be conservative, provided a substantial portion of announced plans materializes more rapidly than forecast.

IV. MACROECONOMIC AND STRUCTURAL POLICIES

A. Creating More Fiscal Space to Continue Improving the Quality of Spending

14. A revised budget law for 2019 was adopted on May 15, reflecting the priorities of the new government.

- The target of 12.3 percent of GDP for net tax revenue is ambitious, with a significant increase of more than ½ point of GDP compared to 2018 outcomes. Tax collection since the beginning of 2019 is encouraging and confirms that the revenue weaknesses in the second part of last year was largely temporary. Further progress will depend on ongoing improvements in tax administration, including stronger verification of declared values for imports, better collection of the VAT payments on public investment projects, enhanced collection of tax arrears, and centralized financial management of the tax receipts.
- Transfers to JIRAMA are unchanged in the revised law and limited to 0.6 percent of GDP, a reduction from 0.8 percent of GDP in 2018. This is in line with JIRAMA 2019 revised budget adopted by the company at the end of March 2019, accounting for resolute cost-cutting measures as an alternative to the planned tariff increase. Further to stepping up the fight against fraud, we made significant progress in the renegotiation of contracts with suppliers which is expected to have a major impact on the financial situation of the utility. On May 15, the Council of Ministers instructed ministries and public institutions to pay their overdue bills for water and electricity consumption to JIRAMA, a departure from some past practice that allowed a payment to JIRAMA of MGA 15 billion planned in July 2019. Should these measures be insufficient to avoid additional losses compared to the revised JIRAMA budget, as a contingency measure, the government will consider, among others, the acceleration of the introduction of additional smart meters and the non-replacement of retirements (expected to generate between MGA 15 and 20 billion in additional savings). In addition, the recent agreement on fuel pricing (see ¶15) will have a favorable impact on JIRAMA's fuel billing. Beyond 2019, the government is designing a medium-term strategy with the support of the World Bank to balance the accounts of the public company, address the issue of accumulated liabilities, and improve the production and distribution of electricity, which is essential for the economic development of the country (see ¶16).
- The 2019 wage bill has been slightly lowered (by MGA 42 billion, less than 0.1 percent of GDP) compared to the initial budget, reflecting government's commitment to implement the wage adjustment after May. The wage bill includes a temporary increase (planned over a four-year period) to pay the past unmet obligations for grade promotions (*dette d'avancement*). The wage bill is limited to 5.7 percent of GDP in 2019, and 44 percent of gross tax revenue.
- The amount of transfers to the civil servants and military pension fund remains at 0.7 percent of GDP. While confident that the pension fund deficit for 2019 will be contained at this level, any potential additional limited slippage will need to be compensated by additional spending under "Other Net Treasury Operations". We are working on reflecting in the budget credible assumptions for the expected deficit, and on reforms needed to avoid the deficit becoming unsustainable in the future (see ¶16).

- In light of the government's priorities, the 2019 revised budget law reflects efforts to improve the quality of spending: expenditures on goods and services are reduced by MGA 60 billion (0.13 percent of GDP), notably through the cancellation of non-essential credits, including for fuel and telecommunications of ministries and administrations, and savings from the absence of Parliament since end-February before the elections of May 27. Transfers are slightly increased (by MGA 38 billion or 0.08 percent of GDP) to accommodate spending related to a vaccination campaign against the measles epidemic, and security measures promised by the president.
- Domestically-financed public investment spending increased by MGA 273 billion (0.6 percent of GDP) and its focus has been streamlined; it is expected to reach 3.4 percent of GDP in 2019 compared to 2.1 percent of GDP in 2018. With externally-financed investment projected at about 5 percent of GDP, total public investment should surpass the initial objective (under the ECF arrangement) of 8 percent of GDP in 2019. These ambitious objectives will be supported by ongoing efforts to improve implementation capacity (see ¶16).
- As a result of these changes in spending in the revised budget law, priority social spending (as defined for the IT under the TMU, ¶22) will increase in 2019 compared to the initial budget (in which they were set at 1.2 percent of GDP). The additional funds of 0.6 percent of GDP in domestic investment are initially allocated to the Ministry of Economy and Finance and will be reallocated to the different ministries taking to account their progress on investment projects and their priorities. We estimate that about one third of this additional spending will be allocated to social sector ministries, which suggests that priority social spending may reach 1.4 percent of GDP. Also, this does not include other social spending (like the vaccination campaign already mentioned) that is counted as expenses of the Presidency or the Prime Minister Office, and therefore excluded from the definition of the IT on social spending.
- Overall, the domestic primary balance is expected to amount to a deficit of less than 0.4 percent of GDP in 2019, compared to a slight surplus of 0.1 percent in the initial budget. It should be noted however that (i) this does not endanger the achievement of the fiscal PC for end-June 2019 (last test date for the program), as these additional expenditures will be committed in the second half of the year; and (ii) had there been a PC for end-December 2019 consistent with a surplus of 0.1 percent of GDP, it would have been reachable given the adjustment provided for in the TMU in case of additional budget support.
- With budget support committed by the World Bank and African Development Bank of US$214 million (1.7 percent of GDP), full financing of the budget remains ensured. Net domestic financing is projected at 0.9 percent of GDP, compared to 1.2 percent of GDP on average over the 2015-2018 period.

15. On fuel pricing, as part of the plan to avoid significant lasting liabilities, we set a new reference price structure in June 2019, and remain committed to implementing an automatic fuel pricing mechanism starting September 2019 alongside measures to minimize the impact on the poor.

- The first step towards the establishment of a new pricing mechanism avoiding any lasting significant liability (to be implemented by end-September 2019), was the setting of a new reference price structure, based on several studies, including the World Bank. Before the implementation of this new reference price, and given recent evolutions of parameters like the price of Brent (+19 percent between end-2018 and end-May 2019), the MGA/US$ exchange rate, and the consumption of fuel products, in May 2019 the reference price was higher than pump price by 8.2 percent. A significantly lower reference price (by more than 12 percent on average) was implemented by a ministerial order signed in June 20, 2019. This new price structure is applied retroactively to January 2019.

- The establishment of the new price structure reduces our existing accumulated liabilities to the distributors. With the new price structure applied from January 2019, the liability is reduced to less than MGA 110 billion in June 2019 (compared to MGA 192 billion under the previous price structure). This accounts for the MGA 100 billion that was settled in December 2018 through the cancellation of payments due by fuel distributors to the Road Maintenance Fund. Any remaining liability will remain well below the limit of MGA 175 billion set at the time of the fourth review, will be below the limit of MGA 140 billion at end 2019, and will be settled steadily by end-2020—if needed through a temporary surcharge in pump price.
- Together with the establishment of the new reference price formula, the government took the decision to lower pump prices, effective in June 20, 2019, by about 4.5 percent on average, but by almost 20 percent for kerosene (MGA 500 per liter) to protect the poorest households. After this one-off adjustment, and in the interim period before implementation of the fuel pricing mechanism, the government intends, if needed, to adjust the pump price to reflect developments in the reference price. Communication efforts have started to explain the changes in the price structure and the fuel pump price to the population, including publishing updated information on the OMH website.
- These decisions remain consistent with the government's continued commitment to implement a fuel pricing mechanism no later than end-September 2019, combining two elements: an automatic price calculation with a smoothing formula, along with a limited discretionary adjustment, which could help manage potential social impact. The smoothing formula could lead to some limited, transparent and predictable accumulation of liabilities—in either direction depending on price movements—between the government and distributors; both parties agree to accept this accumulation. The continuing application of this mechanism, including interim pricing arrangements until September and use of the full fuel price mechanism beyond, remains a continuous structural benchmark (for details, see TMU, ¶25).

16. Beyond the 2019 budget, we remain committed to increasing fiscal space over the medium term for priority spending:

- We aim to contain the wage bill at a sustainable level, with the objective of continuing its reduction as a percentage of tax revenue. The use of our IT tool for payroll management (AUGURE) will improve the accuracy and comprehensiveness of the budget in this area. These forecasts will include the payment of teachers that are not part of the civil servants (currently budgeted under transfers), as well as all allowances, including the "*dette d'avancement*" accumulated by postponing promotions. On the latter, we will fulfill past unmet obligations for grade promotions, which requires additional one-off outlays over the period 2019-2022. Building on past verifications of ministries' payroll, efforts will continue to enhance the management of the payrolls. Our objective is also to ensure the alignment of wage bill projections and sectoral medium-term spending plans, and to adopt, in due course, an updated overall strategy of modernization of Madagascar's civil service.

- Total transfers are highly dependent on the amounts allocated to the civil servants and military pension fund (25 percent of total transfers, and 34 percent of transfers excluding JIRAMA, in 2018). A Fiscal Affairs Department (FAD) technical assistance mission in April 2019 proposed measures to better assess the anticipated deficit and accommodate related government financing in the budget, as well as a set of cost saving reforms (indexing pensions to prices and not wages, gradually eliminating pension increments depending on the number of adult children and on national honors and reducing accrual rates). The government will assess the impact of these measures and potential other parametric changes and is determined to implement some of these changes starting with the 2020 budget.
- On JIRAMA, we are revising our plan to gradually eliminate transfers for JIRAMA's operating losses (as previously committed), together with a broader strategy to ensure the long-term financial viability of the utility, including with the settlement of existing liabilities estimated to up to 4.5 percent of GDP. While relying as much as possible on aggressive cost-reduction, the government will pursue revenue generating measures, including by launching a study on tariff realignment ("*péréquation tarifaire*") in the coming weeks. These efforts fit into the overall strategy to rapidly expand access to affordable electricity, as Madagascar ranks 185th in the World Bank's Doing Business "electricity supply" category, making electricity access the second most important barrier for private sector investment.
- The success of the multi-year business plan of Air Madagascar after its recent restructuring will be instrumental in avoiding the need for public subsidies in the future. The government is determined to fulfill its obligations under the partnership agreement, such as swiftly concluding the settlement of specific liabilities of Air Madagascar and find remedial measures for the phasing in of additional landing rights for foreign airlines.
- Domestically-financed investments are planned to increase from 2.1 percent of GDP in 2018 to 3.4 percent of GDP in 2019, then remain above 3 percent per year by 2021, and externally-financed investments from an estimated 3.6 percent of GDP in 2018 to at least 6 percent of GDP per year on average over the 2019-2021 period. This will require additional efforts to boost investment implementation capacity (see below).
- Strengthening social policies and spending is among the highest priorities of the government. We plan to increase priority social spending from 1 percent of GDP in 2018 to almost 2 percent of GDP by 2021. We also plan to expand existing social safety nets, like the Human Development Cash Transfer—a conditional cash transfer program providing regular cash benefits for families with children 0-12 years—and the Madagascar's Productive Safety Net program—which provides cash for work opportunities over three years. These programs are supported by the World Bank, which recently provided a US$ 90 million grant, retroceded to the Development Intervention Fund. This record funding for safety nets in Madagascar will help the government increase access of the poorest households to safety nets and lay the foundation for a social protection system.
- **Fiscal risks**. We are strengthening our fiscal risk management. The 2019 budget followed the good practice established for 2018, with the publication of an annex on fiscal risks. With support of an FAD TA mission planned in July 2019, we will further strengthen this analysis within the 2020 budget, including more details on appropriate measures if these risks materialize. Given the expected increase in public guarantees, we will take stock of all public-sector guarantees

(including those to SOEs). We are studying the feasibility of provisioning for all new guarantees (for instance for 15 percent), which could begin with the 2020 budget. It is particularly important to manage the fiscal risks associated with public-private partnerships (PPPs). The institutional framework and procedures are in place to manage these risks; our staff have the technical skills to assess the financial viability of each project. We plan to set limits on overall guarantees for PPPs. Supported by the World Bank and the African Development Bank, we are also developing standard guidelines to be used within the different Ministries. Two complementary decrees on small-scale PPP contracts are ready, but need to be examined by the Business Law Reform Commission (*Commision de Réforme du Droit des Affaires*, CRDA) and validated by the government, which could take a few months. For transparency purposes, we are committed to publish the terms and conditions of all PPP contracts within one month of the date of their signature on the website of the Ministry of Economy and Finance (continuous structural benchmark).

- **Investment capacity**. We are reinforcing our efforts to build investment capacity, as the pace of scaling up public investment has not accelerated as much as initially targeted. A February 2019 follow-up FAD mission on public investment management assessment (PIMA) confirmed persistent gaps at different stages of the investment cycle (planning, allocation, and implementation) and helped prepare a guide to streamline procedures to speed-up project management and reduce administrative delays, while strengthening controls. The Organization for the Coordination and Monitoring of Investments and their Financing (OCSIF), which remains in charge of coordinating and trouble-shooting investment, is developing a comprehensive database of all projects to improve their monitoring and detect implementation issues. Also, with AFRITAC South support, we are developing rules and procedures to improve budgeting and monitoring of multi-year capital projects, including IT tools to monitor multi-year projects in "*autorisations d'engagement/credits de paiements* (AE/CP)." We will set up a team led by the Budget Department to start implementing the new procedures to account for and manage the AE/CP for selected ongoing multiyear public investment projects in the context of the 2020 budget. Following another recommendation from the PIMA TA mission, efforts are made to strengthen inter-ministerial coordination to ensure better complementarity of investment projects.

17. We will continue to use primarily concessional borrowing to fund much-needed investment responsibly subject to the implementation and absorptive capacity while containing risks of public debt.

18. We remain committed to further improve revenue collection, particularly domestic revenue:

- The gradual increase in the net tax-to-GDP ratio in recent years, from 9.9 percent of GDP in 2014 to 11.7 percent of GDP in 2018, has been a major achievement. We relied on the action plans for tax and customs administration, as well as on some specific fiscal measures. For instance, the increase in the tax on petroleum products (TPP) resulted in an additional MGA 128 billion (including the associated increase in collected VAT), equivalent to more than 0.3 percent of GDP, in 2018. For further progress, we will continue to build on IMF's Fiscal Affairs Department (FAD) technical assistance missions: we are implementing the recommendations of the February 2018 mission, and another mission is planned in October 2019. Our objective is to reach 12.3 percent of GDP in 2019, and to exceed 13.0 percent of GDP starting 2023.

- Specific efforts are needed for domestic tax collection. Indeed, after early success in 2016 (when domestic tax revenue reached 5.6 percent of GDP, up from 4.9 percent of GDP one year earlier), progress has been limited, with a quasi-stagnation in percent of GDP. We will focus on (i) the generalization of performance contracts at the Directorate General for Taxes (DGI) (from 36 of the 113 operational units in 2018 to all of them by the end of 2019, faster than originally planned; (ii) the consolidation of the taxpayer segmentation (with a better transfer of the cases between the different units), considering that the largest taxpayers managed by the Directorate of Large Enterprises (DGE) account for 0.2 percent of total taxpayers and 80 percent of total tax collection; (iii) the strengthening of fiscal controls, based on risk analysis, targeting companies whose VAT payments show inconsistency with the evolution of their turnover, and the reorganization of selection procedures towards more transparency, facilitated by the use of the unique TIN now enforced in the departments of the Ministry of Economy and Finance; and (iv) the strengthening of our recovery plan for outstanding tax payments (*Restes à recouvrer, RAR*), which represented MGA 454 billion (1.1 percent of GDP) at the end of 2018, of which about MGA 127 billion should be recovered in 2019.

- Regarding custom revenue, the aim is to build on the strong performance of recent years (in nominal terms, revenue increased by more than 65 percent since 2015), despite some lower tariffs arising from Madagascar's trade agreements. Building on recommendations of recent TA missions, we plan to adjust the performance indicators and expand performance contracts to smaller customs offices, to the clearance center, and to the risk analysis center. All managers will also sign *conventions d'objectif*. Nearly all major offices were equipped in 2018 with the ASYCUDA World system, which started to improve the sequencing and timeliness of clearance operations. We are also improving our control process, with systematic profiling and risk analysis as soon as the goods are loaded, as well as with the comparison of prices declared by importers with other sources of objective transactional values. In order to secure the tax base, a control strategy targeting companies, free zones, and zones under exceptional tax regimes, coming with a chronogram of actions, will be established by end-July 2019. We plan to improve the information system by putting open data online, contributing to the strengthening of internal control at Customs and the provision of tools external stakeholders. An analysis in collaboration with major universities is also underway to develop our tools for risk analysis. We are also planning the establishment of a specific statute for Customs Administration agents to optimize our Human Resources Management.

- The tax policy unit, whose main task is to conduct a comprehensive analysis of domestic tax and custom revenue, including tax policy options, will continue to report to the Secretary General of the Ministry of Economy and Finance. The unit has already undertaken an impact analysis of tax expenditures for 2016 and 2017 and is completing the one for 2018. It is also finalizing an analysis of the tax potential in Madagascar. It also plans the publication of the 2018 annual review of tax policy, and the launch of a study on international practices on taxation for special economic zones.

19. We are determined to ensure that new tax incentives for investment are effective and cost-efficient to safeguard our core objective of boosting revenue collection. For the implementation of the new law on Special Economic Zones approved by Parliament in April 2018, we reiterate our commitment to start with pilot projects limited to at most two geographic locations, which will focus exclusively on exports in one or two clearly defined sectors. The implementation of the Law for Industrial Development will likewise start with pilot projects limited to at most two geographic locations, which will focus on one or two clearly defined sectors. For these two laws, the tax code revisions and issuance of implementing decrees will rely on cost-based incentives (investment credits or accelerated depreciation exclusively for capital goods) rather than profit-based incentives, consolidate all tax incentives into the tax law, and adopt rules-based approaches to avoid discretion in granting tax incentives. Before taking any further actions, we will assess the costs and benefits of pilots for both laws. More broadly, we plan to review the tax code as the overarching legal framework governing tax incentives with a view to harmonizing the regimes in the medium-term (including the free trade zones or *zones franches*), drawing on technical assistance in this area from the IMF and other partners. We will continue to publish an annex to the budget law with estimates of the fiscal costs of key tax incentives, as was done for the 2019 budget.

B. Enhancing Economic Governance and Fighting Corruption

20. Efforts to strengthen the governance framework are advancing. We have significantly strengthened the legal framework with the adoption of several laws (*law against the traffic of precious woods* in 2015, *anti-corruption law* and *law on anti-corruption courts* in 2016, *international cooperation law in criminal matters* in 2017. The law on *anti-money laundering and combating the financing of terrorism (AML/CFT)*, which brings our AML/CFT framework into closer alignment with international standards, was enacted in February 2019, after first being submitted in December 2017. To expedite their application, we will issue the implementation decrees associated with the anti-corruption law and AML/CFT law by end-September 2019. Finally, the *asset recovery law*, which ensures that judicial authorities can seize and confiscate proceeds of crime, initially submitted to Parliament in December 2017, has been adopted through Presidential ordinance (decision by the Council of Ministers on June 28, 2019). To make further progress in terms of transparency, we have started publishing all reports and decisions of the Court of Accounts as of February 2019.

21. We are also reinforcing the institutions for effective enforcement of this new legal framework. Quarterly statistics on corruption cases based on investigations made by the anti-corruption office (BIANCO) and the financial intelligence unit (SAMIFIN) (consistent with the technical memorandum of understanding, TMU) have been regularly published since April 2018. The first anti-corruption court has been opened in Antananarivo in June 2018 and the establishment and operationalization of a second one in Mahajanga is ongoing. The online platform to publish all final court decisions by the anti-corruption courts providing searchable internet access (using the criteria of topics and presiding judges), has been operational since early December 2018. To implement the anti-corruption law, the establishment of a mechanism to verify asset disclosures from officials (covered under article 41 of the constitution and Article 2 of the anti-corruption law) will become operational with the adoption of the related decree (see preceding paragraph). Over the medium term, to ensure that asset declarations are comprehensive (covering both assets legally owned and beneficially owned), verifiable, subject to dissuasive sanctions for non-compliance, and progressively made publicly available online, we are drafting a strategy, starting with discussions with new authorities for the necessary legal reforms, including drafting the legal texts, for consideration by the government in 2019.

22. **We remain committed to strengthen public financial management (PFM), as part of our efforts to enhance good governance, transparency, and sound public finances**. The PEFA self-evaluation completed in January 2018 found progress, but also some persistent weaknesses. In July 2018, we adopted an updated 2018-2026 Strategic Plan of Modernization of Public Financial Management, including its translation into an Action Plan for the 2018-2020 period, building on the conclusions of Fund FAD TA.

- We developed a medium-term fiscal framework in 2017, and we are working on strengthening the budget preparation process. Recent improvements include the publication of annexes to the budget on fiscal risks (starting with the 2018 budget) and on fiscal costs of key tax incentives (with the 2019 budget). We are also working to improve the wage bill and the civil pension fund forecasts, drawing on IMF TA, as well as revenue forecasts, relying on the Tax Policy Unit.
- The new draft law on treasury management is expected to be submitted to the first Parliamentary session starting in mid-2019, and the regulatory text on the functioning of the single Treasury account is being finalized and will be published by end-2019.
- We will continue to enhance the management of fiscal risks and the coverage of the budget, by better supervising and integrating autonomous entities, SOEs, and PPPs. The revised law governing the National Public Establishments (*Etablissements publics nationaux*, EPN), which received a budget allocation equivalent to 0.5 percent of GDP in 2018, was adopted in December 2018; inter-ministerial discussions are ongoing to finalize the application decrees planned to be issued by end-September 2019. The law enhances supervision, transparency, and accountability of EPNs, as well as clarify their categorization. We published in December 2018 an updated list of all the EPNs: a total of 224 were identified, 133 at the central level and 91 decentralized.
- To implement the Code of Public Procurement passed in 2017, the separation of the functions of regulation and control is now effective. We are also working on the decree to formalize and sustain the funding of the ARMP (Authority of Regulation of Public Procurement). Actions following up on the audit of ARMP completed in September 2017 have been incorporated into the broader PFM action plan. We are conducting outreach activities to inform the private sector and civil society of these improvements. We are ready to make public and easily accessible a registry of companies that have violated the procurement regulations and are prohibited from participating in future bids (SB for end-August 2019), but without any cases at this stage. Finally, we expect to conclude a study on migrating to an e-procurement system by end-2019.
- We are strengthening our debt management strategy by updating and reporting statistics regularly, documenting contingent liabilities exhaustively, and extending the maturity of domestic debt instruments to reduce exposure to rollover and interest rate risks. The 2018 DEMPA (Debt Management Performance Assessment) noted the ongoing progress on this front as well as areas for further improvements.
- To reinforce ex post controls and the PFM system's contribution in the fight against corruption, we are strengthening audit bodies and internal inspections, especially the Court of Auditors (*Cour des comptes*). In 2018, we have started publishing the final decisions taken by the Council of Budgetary and Financial Discipline, as well as statistics on its action (including decisions).
- Finally, to improve coordination and leadership of our PFM reform strategy, we have reorganized the steering committee. We are also testing a portal dedicated to PFM reforms on the website of

the Ministry of Economy and Finance to promote the exchange of information between all the stakeholders of the reforms, which should be launched by the end of 2019.

C. Maintaining Stable Inflation and Building External Resilience

23. **We remain committed to keeping inflation in single digits, with a focus on managing fluctuations in bank liquidity**. Our success in building international reserves, with larger-than-anticipated accumulation over 2016-18, increased bank liquidity that the central bank has successfully contained. The BFM is strengthening its monetary policy framework with several objectives including improving the management of commercial bank excess liquidity and continuing the gradual move from monetary to interest rate targeting. In an effort to progressively implement indirect instruments, the BFM introduced in May 2019 an overnight rate (set at 0.9 percent), in addition to the BFM key policy rate for one-year maturity transactions. A 36-week maturity T-bill has been introduced in January 2018. To support the use of collateral for interbank lending, the draft legislation on repo transactions was submitted to Parliament in December 2018 (structural benchmark) and should be examined by Parliament in its first session following the May 2019 elections. The principle of appropriate discounts on debt instruments when used as collateral for borrowing from the BFM, as commonly done internationally in monetary markets, has been introduced in this law. In preparation for these operations, a convention between the Ministry of Economy and Finance (MEF) and the BFM will grant the BFM real-time access to the database on Treasury bonds (BTFs). A law on collateral (*suretés*) is also in preparation with the Ministry of Justice, to be tentatively submitted to Parliament by the end of the year.

24. **In pursuit of our mission of safeguarding external stability, we will continue building international reserves, in the context of a flexible exchange rate regime**. We will aim to increase reserves to about SDR 1300 million by end-2019 depending on the timing of external program support and other circumstances. Our long-term objective, consistent with convergence criteria at the regional level, is to gradually increase import coverage to 6 months or more. As mentioned above, our interventions are guided by an algorithm (developed with Fund technical assistance) to limit exchange rate volatility and build reserves.

D. Building a Sound Financial Sector Supporting Growth

25. **Efforts to promote greater access to financial services are ongoing**. Following the modernization of the legal framework, by adopting and enacting a law regulating the establishment, the licensing, the operations, and the supervision of a private credit bureau, we selected an investor in July 2018. The bureau received its license in December 2018, and preliminary work on data collection is underway, to be completed in the second half of 2019. After the issuance in September 2017 of decrees on the implementation of the law on electronic money and electronic money institutions, the development of payment through electronic money is ongoing, notably with the licensing of a first company to provide these services and the processing of two other applications.

26. **Reinforcing financial stability, implementing risk-based supervision (RBS), and containing systemic risk remain priorities**:

- The new banking law to be submitted to Parliament by end-July 2019 will: (i) improve the bank recovery and resolution framework in line with the Financial System Stability Assessment (FSSA) recommendations; (ii) enhance the powers and independence of the financial supervisor (CSBF), including legal protection of Commission members and supervisors; and (iii) reinforce the framework for corrective bank supervisory measures, with specific triggers, responsibilities, and time limits for an effective response to bank violations and vulnerabilities to be determined by the law or regulation.

- We will approve updated prudential directives by end-2019 on capital adequacy, liquidity, concentration of risks, and classification and provisioning of credit risks, in line with international standards and FSSA recommendations.
- A law on financial stability, in line with international best practices, has been drafted and is awaiting validation by the Committee for the Reform of Business Laws (Commission de Reforme du droit des affaires, CRDA) before submission to Parliament (SB for end-June 2019). It will establish a national structure in charge of analyzing, identifying, and preventing systemic risks, as well as managing and addressing financial crises.
- Significant progress has been made towards the implementation of risk-based supervision (RBS) drawing on the action plan adopted in December 2017. The methodological framework for individualizing the risk profile of banks has been finalized with the technical support of a Fund AFRITAC South expert in May, a new software has been deployed, and additional staff recruitment and training are underway with the view to start implementing effective RBS both in the banking and microfinance sectors.

27. Concerning non-bank financial institutions, the work to follow-up on recent audits of the CEM *(Caisse d'Epargne de Madagascar)* and PAOMA *(Paositra Malagasy)* is continuing. In March 2019, CEM obtained its license by the CSBF to operate as a microfinance institution, in line with the existing action plan. The government intends to set up a working group to elaborate a development plan for PAOMA, which has started taking stock of its property assets and is preparing a full audit of its customer accounts.

28. With support of the IMF TA, we are working to further develop the foreign exchange market, which remains shallow and prone to volatility. This situation typically worsens during periods of volatile foreign exchange movements when some bank clients chose to keep significant balances in foreign currency accounts or not repatriate export proceeds for speculative reasons. Considering the situation, the MEF, in consultation with the BFM, introduced a surrender requirement of 100 percent in August 2014, which was reduced to 70 percent in June 2016. We have prepared a draft revised law on the foreign exchange market, based on Fund TA to be tentatively validated by the MEF and BFM by end-June 2019, with the aim of submission to Parliament by October 2019. Following adoption of the law, we intend to issue the implementing ordinances and to adopt the plan to phase out surrender requirement. The plan aims at gradual phasing out if conditions do not destabilize the market. In this regard, we have conducted further technical analysis of the market and anticipate additional new potential sources of volatility as repayment of foreign financing increases.

29. The BFM's modernization is continuing, with a reform agenda to increase transparency and to render it more financially independent. BFM remains committed to full adoption of International Financial Reporting Standards (IFRS) for the 2020 accounts (expected by April 2021).

We have developed an action plan, supported by IMF technical assistance, to achieve this goal, and we in May finalized a gap analysis to be followed by pro-forma IFRS financial statements for fiscal year 2018. We have scheduled more capacity building for late 2019. We will also consider the capital adequacy of the BFM, including the possible impact following full IFRS implementation, as part of a longer-term strategy to safeguard the financial autonomy of the bank. We have also made progress with the destruction of old bank notes, and the stockpile that existed at end-December 2017 was eliminated by end-June 2018 and we are preventing any new backlog. In 2019, the internal audit department will conduct a review of the implementation of the revised bank-wide procurement policy approved in June 2017. This audit will be repeated periodically. More broadly, we will continue our efforts to strengthen our internal and external audit mechanisms as per the safeguards recommendations.

E. Improving the Quality of Statistics

30. A new statistics law, modernizing and regulating data collection, was enacted in April 2018. This law was prepared with technical assistance from the UNDP, and application decrees are being finalized to: (i) spell out organizational arrangements, including the institutional status of INSTAT (National Institute of Statistics); (ii) strengthen coordination among ministries, including the establishment of the National Council of Statistics; (iii) improve information and data flows, and (iv) set up a statistics development fund.

31. While data provision is broadly adequate for program monitoring, we are taking measures to address shortcomings in the areas of real sector, monetary and financial sector, balance of payments, and government finances statistics:

- On the real sector, revised series of annual national accounts for the 2007-2017 period with the base year 2007 based on SNA 1993 methodology were finalized and published. INSTAT also produced experimental quarterly GDP estimates under the new base year. The government is in the process of switching to use the rebased GDP series, which will be the case for the preparation of the 2020 budget. As of May 2019, INSTAT is producing a reweighted consumer price index (CPI) to better account for current consumption patterns.
- Regarding monetary and financial statistics, we achieved in 2018 the consolidation of balance sheets of larger micro-financial institutions and the CEM in the preparation of the monetary survey.
- We are implementing recommendations of IMF TA on balance of payments and international investment position (IIP) statistics. We are emphasizing the enhancement of information collection, have assessed the foreign direct investment survey and have launched surveys to collect data on financial transactions and on international transport and tourism, insurance, and manufacturing services. We have compiled a preliminary version of the IIP and have started connecting some of the balance of payments data deficiencies identified by the mission.
- On government finance statistics, we have prepared 2017 budget execution statistics under the 2014 GFSM and we are starting 2018. We aim to use this methodology starting with the publication of the end-December 2019 statistics. We plan to gradually extend the statistical coverage from the central government to the general government, including local authorities and national public establishments (EPNs).

32. A general census of the population and housing, the third since independence, is being finalized. The last census was completed in 1993. Data have been collected and are currently being processed. This will be followed by the analysis and publication of preliminary results by end-2019.

33. We remain committed to allocate sufficient human, financial, and material resources to the production of statistics. The government will continue to support INSTAT in fulfilling its missions, in particular the production of national accounts, consumer price index, and production price index. We are working to fill vacancies for BOP compilation. We also count on increasing technical and financial assistance from our partners, including for forecasting using the rebased national accounts.

V. PROGRAM MONITORING

34. The sixth and last review will be evaluated based on quantitative performance criteria at end-June 2019 and structural benchmarks up to the end of the ECF-arrangement. Quantitative targets for end-June 2019 (Table 1) remain the same as those set at the time of the fourth review. Structural benchmarks are specified in Table 2. Definitions of key concepts and indicators, as well as reporting requirements, are set out in the accompanying Technical Memorandum of Understanding (TMU). The sixth and last review is scheduled to be completed on or after November 20, 2019, based on test dates for periodic performance criteria of end-June 2019 and structural benchmarks.

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets, June 2019

	2019
	End-June
	Performance Criteria
	(Billions of Ariary; unless otherwise indicated)
Fiscal	
Floor on primary balance excl. foreign-financed investment and grants (commitment basis) [1]	-22
External	
Ceiling on accumulation of new external payment arrears (US$ millions) [2]	0
Ceiling on new external debt contracted or guaranteed by the central government or BFM, in present value terms (US$ millions) [4]	900
Central bank	
Floor on net foreign assets (NFA) of BFM (millions of SDRs) [5]	833
Ceilings on net domestic assets (NDA) of BFM [5]	1,521
Indicative targets	
Floor on social priority spending [1]	198
Floor on gross tax revenue [1]	2,800
Ceiling on new nonconcessional external debt with original maturity of more than one year, contracted or guaranteed by the central government or BFM (US$ millions) [3]	
Grant element of less than 35 percent	383
Grant element of less than 20 percent	100
Ceiling on new nonconcessional external debt with original maturity of up to and including one year, contracted or guaranteed by the central government or BFM (US$ millions) [2]	0
Memorandum items	
Official external program support (millions of SDRs) [3]	331
Official external program grants (millions of SDRs) [1]	28
Program exchange rate (MGA/SDR)	4,444

Sources: Madagascar authorities; and IMF staff projections.

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

[2] Cumulative ceilings that will be monitored on a continuous basis starting from end-May, 2016.

[3] Cumulative ceilings that will be monitored on a continuous basis starting from January 1, 2016.

[4] Cumulative ceilings that will be monitored on a continuous basis starting from January 1, 2018.

[5] The total stock of NFA and NDA measured at the program exchange rates.

Table 2. Madagascar: Structural Benchmarks for the Rest of the Program

Action	**Dates**	**Rationale**
Mobilizing fiscal revenue		
Adopt a strategy for the control of high-risk sectors, such as free trade zones and new special economic and industrial zones	End-July 2019	Safeguard revenue
Improving the composition and quality of fiscal spending		
Implement an automatic fuel price formula with a smoothing mechanism no later than end-September 2019, while avoiding budget costs from fuel pricing in the interim.	Continuous benchmark	Critical to contain transfers
Enhancing economic governance		
The terms and conditions of all PPP contracts will be published within one month of the date of signature on the web site of the Ministry of Economy and Finance.	Continuous benchmark	Critical to enhance transparency and accountability
Notify World Bank and IMF staff in advance of any single source procurement contracts for JIRAMA's purchases of fuel and electricity and purchases and rentals of generators.	Continuous benchmark	Critical to enhance transparency and accountability
Establish a public registry of companies that have violated the procurement regulations and are prohibited from participating in future bids.	End-August 2019	Transparency and value for money
Strengthening financial sector development		
Submit to Parliament a law on financial stability, in line with international standards and FSAP recommendations, establishing the structure in charge of analyzing, identifying, and preventing systemic risks as well as managing and addressing financial crises.	End-June 2019	Financial stability

Attachment II. Technical Memorandum of Understanding July 2019

1. This technical memorandum of understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Tables 1 and 2, which are attached to the Memorandum of Economic and Financial Policies for 2019. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year.

DEFINITIONS

2. For purposes of this TMU, **external** and **domestic** shall be defined on a residency basis.

3. Government is defined for the purposes of this TMU to comprise the scope of operations of the treasury shown in the *opérations globales du Trésor* (or OGT). The government does not include the operations of state-owned enterprises and sub-national authorities.

4. The program exchange rates for the purposes of this TMU[1] are as follows:

Program Exchange Rates	
Malagasy Ariary (MGA)/SDR	4,443.86
U.S. Dollar/SDR	1.389049
Euro/SDR	1.270538
Australian dollar/SDR	1.903723
Canadian dollar/SDR	1.926401
Japanese Yen/SDR	167.377024
Swiss Franc	1.375855
U.K. Pound Sterling/SDR	0.937470

5. Foreign currency accounts denominated in currencies other than the SDR will first be valued in SDRs and then be converted to MGA. Amounts in other currencies than those reported in the table above and monetary gold will first be valued in SDRs at the exchange rates and gold prices that prevailed on December 31, 2015, and then be converted to MGA.

6. Performance criteria included in the program, as defined below, refer to the net foreign assets and net domestic assets of the central bank, external payments arrears, non-concessional new external debt owed or guaranteed by the central government and/or the central bank, and the domestic primary balance (commitment basis). Performance criteria are set for end-December 2018 and end-June 2019, while indicative targets are set for end-March 2019.

7. Total government revenue is comprised of tax and nontax budget revenue (as defined under Chapter 5 of GFSM 2001) and grants. Revenue is recorded in the accounting system on a cash basis. Taxes on the import of petroleum products, paid through the issuance of promissory notes, are

[1] Data refer to the mid-point reference exchange rates published on the CBM's webpage for December 30, 2015.

recorded under revenue at the time of the issuance of the promissory notes: to reconcile the difference in timing between the issuance of the promissory note and its actual payment to the Treasury, an equivalent amount is recorded (negatively) under the line "other net transactions of the Treasury" until the actual payment.

8. The authorities will give prior notification to World Bank and IMF staff of any single source procurement contracts for JIRAMA's purchases of fuel and electricity and purchases and rentals of generators. Prior notification entails that World Bank and IMF staff will receive written communication at least 3 working days before the signing of the contract. The signing of addendums and extensions of previously signed contracts are also subject to the requirement of prior notification.

PROVISION OF DATA TO THE FUND

9. The following information will be provided to the IMF staff for the purpose of monitoring the program (see Table 1 for details):

- Data with respect to all variables subject to quantitative performance criteria and indicative targets will be provided to Fund staff monthly with a lag of no more than four weeks for data on net foreign assets (NFA) and net domestic assets (NDA) of the Central Bank of Madagascar (CBM) and eight weeks for other data. The authorities will promptly transmit any data revisions to the Fund.

- The Financial Intelligence Unit (SAMIFIN) will continue to publish, on a website that is freely available to the public, quarterly data (no later than the end of the month following the quarter) on reports sent to BIANCO in relation to suspicions of laundering of the proceeds of corruption (Table 2).

- The BIANCO will publish on a website, that is freely available to the public, quarterly data (no later than at the end of the month following the quarter) on the number of persons indicted, the number of persons convicted by a first instance court decision, the number of persons convicted pursuant a final court decision, and the number of verifications of assets disclosures of public officials (Tables 3-6).

- For variables assessing performance against program objectives but which are not specifically defined in this memorandum, the authorities will consult with Fund staff as needed on the appropriate way of measuring and reporting.

QUANTITATIVE PERFORMANCE CRITERIA

A. Fiscal Aggregates

Floor on Primary Balance (commitment basis)

10. The domestic primary balance (commitment basis) is measured as follows:

- Domestic tax and non-tax revenue less domestically-financed capital expenditures and current spending excluding interest payments.
- For the purposes of calculating the primary balance, tax revenues are measured on a net basis, i.e., net of the refund of VAT credits. Current spending excluding interest payments is the sum of expenditures on wages and salaries, goods and services, transfers and subsidies, and treasury operations (net) excluding the refund of VAT credits. The primary balance will be calculated cumulatively from the beginning of the calendar year. For reference, using data at end-December 2017, the value of the primary balance would be as follows:

Primary balance excluding foreign financed investment and grants (commitment basis)	**-362**
Domestic tax revenue (net of VAT refunds)	4,118
Domestic non-tax revenue	122
Less:	
Domestically-financed capital expenditures	700
Current expenditures	3,902
Wages and salaries	2,076
Goods and services	282
Transfers and subsidies	1,467
Treasury operations (net of VAT refunds)	77

B. External Debt

1. Ceiling on Accumulation of New External Payment Arrears

11. 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 CBM. Debt service obligations (including unpaid penalties and interest charges) are considered overdue if they have not been paid 30 days after the due date or after the end of 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 the creditor has accepted in writing to negotiate alternative payment schedules, as well as debt service payments in conformity with contractual obligations that fail to materialize on time for reasons beyond the control of the Malagasy authorities. This monitoring target should be observed on a continuous basis from end-May 2016.

Ceilings on New External Debt

12. For program monitoring purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows; the grant element of a debt is the difference between the nominal value of debt and its present value (PV), expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is 5 percent. Debt is considered as semi-concessional if it includes a grant element of at least 20 percent, calculated as described above.

13. Where an external loan agreement contains multiple disbursements and where the interest rate for individual disbursement are linked to the evolution of a reference rate since the date of signature, the interest rate at the time of signature will apply for the calculation of the PV and grant element for all disbursements under the agreement.

14. For program monitoring purposes, the definition of debt is set out in *Point 8, Guidelines on Public Debt Conditionality in Fund Arrangements, Executive Board Decision No. 15688-(14/107), adopted December 5, 2014* (see Annex 1). External debt is defined by the residency of the creditor.

15. For loans carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the loan would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the loan contract. The program reference rate for the six-month USD LIBOR is 3.37 percent and will remain fixed for the duration of the program. The spread of six-month Euro LIBOR or 3-month Euribor over six-month USD LIBOR is -249 basis points. The spread of six-month JPY LIBOR over six-month USD LIBOR is -286 basis points. The spread of six-month GBP LIBOR over six-month USD LIBOR is -108 basis points. For interest rates on currencies other than Euro, JPY, and GDP, the spread over six-month USD LIBOR is -209 basis points.[2] Where the variable rate is linked to a different benchmark interest rate, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.

16. A performance criterion (ceiling) applies to the PV of new external debt, contracted or guaranteed by the government or CBM. The ceiling applies to debt contracted or guaranteed for which value has not yet been received, including private debt for which official guarantees have been extended. The PV and associated grant element (GE) are determined using the Fund's concessionality calculator or excel template available online. These monitoring targets should be calculated from January 1, 2018 and observed on a continuous basis from completion of the third review under the ECF arrangement. The ceiling is subject to an adjustor defined below.

17. Two continuous ceilings (see paragraph 24) apply to new non-concessional external debt with nonresidents with original maturities of more than one year contracted or guaranteed by the government or CBM. The ceilings apply to debt and commitments contracted or guaranteed for which value has not yet been received. They apply to private debt for which official guarantees have

[2] The program reference rate and spreads are based on the "average projected rate" for the six-month USD LIBOR over the following 10 years from the Fall 2015 World Economic Outlook (WEO).

been extended and which, therefore, constitutes a contingent liability of the government or CBM. The first ceiling concerns new non-concessional external debt with nonresidents with original maturities of more than one year contracted by the government or CBM with a grant element of less than 35 percent and the second ceiling concerns new non-concessional external debt with nonresidents with original maturities of more than one year contracted by the government or the CBM with a grant element of less than 20 percent. These monitoring targets should be calculated and observed on a continuous basis from January 1, 2016 until the completion of the third review under the ECF arrangement.

18. Excluded from the ceilings in paragraphs 15 and 16 are (i) the use of IMF resources; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt (this also applies to liabilities of Air Madagascar assumed by the government in the context of a strategic partnership agreement); and (iii) debts classified as international reserve liabilities of CBM.

19. A continuous ceiling applies to new non-concessional external debt with nonresidents with original maturities of up to and including one year contracted or guaranteed by the government or CBM. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. It applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the government or CBM. This monitoring target should be calculated and observed on a continuous basis from end-May 2016 until the completion of the third review under the ECF arrangement. See paragraph 24.

20. Excluded from the ceiling are (i) concessional debts; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/ prepaid debt (this also applies to liabilities of Air Madagascar assumed by the government in the context of a strategic partnership agreement); (iii) debts classified as international reserve liabilities of CBM; and (iv) normal import financing. A financing arrangement for imports is considered to be “normal” when the credit is self-liquidating.

C. Monetary Aggregates

Floor on Net Foreign Assets of the Central Bank of Madagascar

21. The target floor for NFA of the CBM is evaluated using the end-period stock, calculated using program exchange rates. The NFA of CBM is defined as the difference between CBM’s gross foreign assets and total foreign liabilities, including debt owed to the IMF. All foreign assets and foreign liabilities are converted to SDRs at the program exchange rates, as described in paragraph 4. For reference, at end-December 2017, NFA was SDR 782 million, calculated as follows:

Foreign Assets	
MGA billions, end-2017 exchange rates (A)	4,988.039
SDR millions, end-2017 exchange rates (B)	1,086.925
SDR millions, program exchange rates (C)	1,099.836
Foreign Liabilities	
MGA billions, end-2017 exchange rates (D)	1,458.186
SDR millions, end-2017 exchange rates (E)	317.748
Net Foreign Assets	
SDR millions, program exchange rates (F) = (C) – (E)	782.088

Ceiling on Net Domestic Assets of the Central Bank of Madagascar

22. The target ceiling on NDA of the CBM is evaluated using the end-period stock, calculated at program exchange rates. The NDA of CBM are defined as the difference between reserve money and the NFA of the CBM valued in MGA using the program exchange rates as described in paragraphs 4. It includes net credit to the government, credit to the economy, claims on banks, liabilities to banks (including the proceeds of CBM deposit auctions—*appels d'offres négatifs,* and open market operations), and other items (net). For reference, at end-December 2017, NDA at program exchange rates was MGA 1,083 billion, calculated as follows:

Net Foreign Assets	
SDR millions, program exchange rates (A)	782.088
MGA billions, program exchange rates (B)	3,475.489
Base Money	
MGA billions, end-2017 exchange rates (C)	4,558.154
Net Domestic Assets	
MGA billions, program exchange rates (D) = (C) – (B)	1,082.665

INDICATIVE TARGETS

D. Floor on Priority Social Spending

23. Priority social spending includes domestic spending primarily related to interventions in nutrition, education, health, and the provision of social safety nets. The floor on priority social spending by the central government will be calculated cumulatively from the beginning of the calendar year. The floor is set as the sum of the budget allocations in the *Loi de Finance* to the Ministries of Health, Education, Population and Water, excluding salaries and externally financed investment.

E. Floor on Gross Tax Revenue

24. Government tax revenue is measured on a gross basis, that is, before the refund of VAT credits. It comprises all domestic taxes and taxes on foreign trade received by the central government treasury. Tax revenue excludes: (1) the receipts from the local sale of in-kind grants, (2) any gross inflows to the government on account of signature bonus receipts from the auction of hydrocarbon and mining exploration rights, and (3) tax arrears recorded in the context of regularization operations, such as those related to the recapitalization of Air Madagascar in 2016. Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and the Directorate of Treasury in the Ministry of Finance and Budget. The floor on gross tax revenue will be calculated cumulatively from the beginning of the calendar year. For reference, for the year ending December 2017, gross government tax revenue was MGA 4,329 billion, comprised of net tax revenue of MGA 4,118 billion and VAT refunds of MGA 211 billion.

F. Ceilings on New Non-Concessional External Debt

25. From the completion of the third review under the ECF arrangement onwards, the ceilings for non-concessional debt with maturities of more than one year (paragraph 16; cumulative since January 1, 2016) and of less than one year (paragraph 18; cumulative since end-May 2016) serve as indicative targets.

STRUCTURAL BENCHMARKS

26. For the purposes of the structural benchmark on fuel pricing, avoiding budget costs from fuel pricing is defined and monitored as follows:

- Until the adoption and implementation of an automatic fuel pricing mechanism with a smoothing formula no later than end-September 2019, the authorities will set prices in a manner that prevents total estimated net liabilities to fuel distributors from rising above MGA 175 billion (measured as a cumulative stock) and aims to reduce the level gradually. The estimated total net liabilities to fuel distributors include the existing stock at end-December 2018 (MGA 132.1 billion as reference) and any new liabilities generated by a difference between the reference prices and the pump prices. The estimated total net liabilities to fuel distributors will be calculated by the Malagasy Office for Hydrocarbons (OMH), using the fuel price structure in place as of end-December 2018 or a new fuel price structure established in accordance with prevailing laws and regulations.

- No later than end-September 2019, the authorities will implement an automatic fuel pricing mechanism with a smoothing formula, based on the fuel price structure in place in June 2019. In agreement with the fuel distributors, this automatic pricing mechanism will be combined with possible discretionary adjustments (for social stability reasons), limited as follows: (i) the discretionary adjustments cannot be applied to reduce pump prices (but can be applied to limit price increases or decreases given by the formula); and (ii) the additional cumulative liabilities to fuel distributors linked to these discretionary adjustments will not exceed MGA 50 billion.

- Avoiding budget cost from fuel pricing includes: (i) the estimated total net liabilities to fuel distributors (defined above), including new liabilities from both automatic adjustments associated with a smoothing formula and those generated by discretionary adjustments to the fuel price, is at most MGA 140 billion (i.e. the government has a liability to the distributors of at most MGA 140 billion) by end-2019; (ii) the difference between average pump prices and average reference prices is eliminated for each of the products: super gasoline, kerosene, and diesel by end-August 2019; and (iii) the remaining stock of net liabilities to fuel distributors at-end 2019 (maximum of MGA 140 billion) will be settled by end-2020 at the latest through a price surcharge and, consequently, no transfers will be due to be paid by the government budget to the fuel distributors.

- The authorities will provide to IMF staff the calculations for the estimate of the monthly flow and stock for these net liabilities for each month, as well as the minutes of the agreement with the fuel distributors, by the 14th day of that month.

MEMORANDUM ITEMS

27. Official external program support is defined as grants and loans, including in-kind aid when the products are sold by the government and the receipts are earmarked for a budgeted spending item, and other exceptional financing provided by foreign official entities and the private sector and incorporated into the budget. Official external support does not include grants and loans earmarked to investment projects. Official external program support is calculated as a cumulative flow from January 1, 2016.

28. Official external program grants are defined as grants, including in-kind aid when the products are sold by the government and the receipts are earmarked for a budgeted spending item, and other exceptional financing provided by foreign official entities and incorporated into the budget. Official external program grant support does not include grants earmarked to investment projects. Official external program grants calculated as a cumulative flow from the beginning of the calendar year.

29. New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the CBM measures such debt with a grant element of at least 35 percent.

USE OF ADJUSTERS

30. The performance criteria on net foreign assets of the CBM and net domestic assets of the CBM will be adjusted in line with deviations from amounts projected in the program for official external program support. These deviations will be calculated cumulatively from January 1, 2016. The following is an explanation of these adjustments:

- The floor on NFA will be adjusted *downward (upward)* by the cumulative deviation downward (upward) of actual from projected budget support (official external program support). This adjustment will be capped at the equivalent of SDR75 million, evaluated at program exchange rates as described in paragraph 4.

- The ceiling on NDA will be adjusted *upward (downward)* by the cumulative deviation downward (upward) of actual from projected budget support (official external program support). This adjustment will be capped at the equivalent of SDR75 million, evaluated at program exchange rates as described in paragraph 4.

31. The performance criteria on the primary balance will be adjusted in line with deviations from amounts projected in the program for official external program grants. These deviations will be calculated cumulatively from the beginning of each calendar year. The following is an explanation of these adjustments:

- The floor on the primary balance excluding foreign-financed investment and grants (commitment basis) will be adjusted downward by the cumulative upward deviation of actual from projected official external program support (grants or loans on concessional terms), calculated at quarterly period-average actual exchange rates as described in paragraph 4.

32. An adjustor of up to 5 percent of the external debt ceiling set in PV terms applies in case deviations are prompted by a change in the financing terms. Changes in interest rates, maturity, grace period, payment schedule, commissions, fees of a debt or debts are candidates for the adjuster. The adjustor cannot be applied when deviations are prompted by an increase in the nominal amount of total debt contracted or guaranteed and are subject to debt sustainability.

Table 1. Madagascar: Data Reporting Requirements	
Item	**Periodicity**
Exchange rate data	
Central Bank of Madagascar (CBM)	
Total daily CBM gross purchases of foreign exchange – break down by currency purchased	Daily, next working day
The weighted average exchange rate of CBM gross purchases, the highest traded exchange rate, and the lowest traded exchange rate –break down by currency purchased	Daily, next working day
Total daily CBM gross sales of foreign exchange – break down by currency purchased	Daily, next working day
The weighted average exchange rate of CBM gross sales, the highest traded exchange rate, and the lowest traded exchange rate – break down by currency purchased	Daily, next working day
Total CBM net purchases/sales of foreign exchange - break down by currency purchased	Daily, next working day
Total interbank foreign exchange transactions (net of CBM transactions) - break down by currency purchased	Daily, next working day
Total interbank and retail foreign exchange transactions (net of CBM transactions) - break down by currency purchased	Daily, next working day
Monetary, interest rate, and financial data	
Central Bank of Madagascar (CBM)	
Foreign exchange cash flow, including foreign debt operations	Monthly
Stock of gross international reserves (GIR) and net foreign assets (NFA), both at program and market exchange rates	Monthly
Detailed data on the composition of gross international reserves (GIR), including currency composition	Monthly
Market results of Treasury bill auctions, including the bid level, bids accepted or rejected, and interest rates	Monthly
Stock of outstanding Treasury bills	Monthly
Data on the secondary market for Treasury bills and other government securities	Monthly
Bank-by-bank data on excess/shortfall of required reserves	Monthly
Money market operations and rates	Monthly
Bank lending by economic sector and term	Monthly
Balance sheet of CBM	Monthly, within two weeks of the end of each month
Balance sheet (aggregate of deposit money banks	Monthly, within six weeks of the end of each month
Monetary survey	Monthly, within six weeks of the end of each month
Financial soundness indicators of deposit money banks	Quarterly, within eight weeks of the end of the quarter

Table 1. Madagascar: Data Reporting Requirements (continued)

Item	Periodicity
Fiscal data	
Ministry of Finance and Budget (MFB)	
Preliminary revenue collections (customs and internal revenue)	Monthly, within three weeks of the end of each month
Treasury operations (OGT)	Monthly, within eight weeks of the end of each month
Stock of domestic arrears, including arrears on expenditure and VAT refunds	Monthly, within eight weeks of the end of each month
Priority social spending as defined by the indicative target	Monthly, within eight weeks of the end of each month
Subsidies to JIRAMA's suppliers	Monthly, within eight weeks of the end of each month
State-owned enterprise data	
Data summarizing the operational and financial position of JIRAMA	Monthly, within four weeks of the end of each month, for operational and financial data. Quarterly, by the end of the following month, for the Table on "Total impayés fournisseurs"
Data summarizing the financial position of AIR MADAGASCAR	Quarterly, by the end of the subsequent quarter.
Debt data	
Ministry of Finance and Budget (MFB)	
Public and publicly-guaranteed debt stock at end of month, including: (i) by creditor (official, commercial domestic, commercial external); (ii) by instrument (Treasury bills, other domestic loans, external official loans, external commercial loans, guarantees); and (iii) in case of new guarantees, the name of the guaranteed individual/institution. External public or publicly guaranteed loans signed since January 1, 2016, specifying the nominal value; calculated grant element and PV; and terms, including the interest rate (using the program reference rate for variable rate loans), maturity, commissions/fees, grace period, repayment profile, and grant component.	Monthly, within four weeks of the end of each month Quarterly
External data	
Central Bank of Madagascar (CBM)	
Balance of payments	Quarterly, by the end of the subsequent quarter

Table 1. Madagascar: Data Reporting Requirements (concluded)	
Real sector and price data	
INSTAT	
Consumer price index data (provided by INSTAT)	Monthly, within four weeks of the end of each month
Details on tourism	Monthly, within twelve weeks of the end of each month
Electricity and water production and consumption	Monthly, within twelve weeks of the end of each month
Other data	
OMH	
Petroleum shipments and consumption	Monthly, within four weeks of the end of each month

Table 2. Madagascar: Reports sent by SAMIFIN to BIANCO

Reports disseminated	Members of the Executive Power	Members of the Legislative Power	Members of the Judicial Power	Heads of province and district, Commissaries, Prefects, Mayors	SOE Managers	Others
Aggregated value of suspected money laundering						

Table 3. Madagascar: Number of Persons Indicted

Penal Code Article	President Members of Parliament High Constitutional Court Magistrates	Magistrates	Heads of province and district, Commissaries, Prefects, Mayors	Director of Ministry or equivalent	SOE Managers	Others
Art. 174						
Art. 174.1						
Art. 174.2						
Art. 174.3						
Art. 175						
Art. 175.1						
Art. 175.2						
Art. 176						
Art. 177						
Art. 177.1						
Art. 177.2						
Art. 178						
Art. 179						
Art. 179.1						
Art. 180						
Art. 180.1						
Art 180.2						
Art. 181						
Art. 182						
Art. 183						
Art. 183.1						
Art. 183.2						

Table 4. Madagascar: Number of Persons Convicted—First Instance

Penal Code Article	President Members of Parliament High Constitutional Court Magistrates		Magistrates		Heads of province and district, Commissaries, Prefects, Mayors		Director of Ministry or equivalent		SOE Managers		Others	
	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail
Art. 174												
Art. 174.1												
Art. 174.2												
Art. 174.3												
Art. 175												
Art. 175.1												
Art. 175.2												
Art. 176												
Art. 177												
Art. 177.1												
Art. 177.2												
Art. 178												
Art. 179												
Art. 179.1												
Art. 180												
Art. 180.1												
Art 180.2												
Art. 181												
Art. 182												
Art. 183												
Art. 183.1												
Art. 183.2												

For fines, total value in ariary. For jail, total months (and suspended jail).

Table 5. Madagascar: Number of Persons Convicted—Final Decision

Penal Code Article	President Members of Parliament High Constitutional Court Magistrates		Magistrates		Heads of province and district, Commissaries, Prefects, Mayors		Director of Ministry or equivalent		SOE Managers		Others	
	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail	Fine	Jail
Art. 174												
Art. 174.1												
Art. 174.2												
Art. 174.3												
Art. 175												
Art. 175.1												
Art. 175.2												
Art. 176												
Art. 177												
Art. 177.1												
Art. 177.2												
Art. 178												
Art. 179												
Art. 179.1												
Art. 180												
Art. 180.1												
Art 180.2												
Art. 181												
Art. 182												
Art. 183												
Art. 183.1												
Art. 183.2												

For fines, total value in ariary. For jail, total months (and suspended jail).

Table 6. Madagascar: Verification of Asset Disclosure Forms

	Forms received	Forms verified	Cases submitted for investigation for non-declaration	Cases submitted for investigation for inconsistencies in the declaration
President Members of Parliament High Constitutional Court Magistrates				
Magistrates				
Heads of province and district, Commissaries, Prefects, Mayors				
Director of Ministry or equivalent				
SOE Managers				
Others				

Annex I. Guidelines on Performance Criteria with Respect to External Debt

Excerpt from paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), adopted December 5, 2014.

1. (a) For the purpose of these guidelines, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

(b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

July 10, 2019

FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—DEBT SUSTAINABILITY ANALYSIS

Approved By
David Owen and Zuzana Murgasova (IMF) and Marcello Estevao (IDA)

Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)[1]

Madagascar Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	***Low***
Overall risk of debt distress	***Moderate***
Granularity in the risk rating	***n/a***
Application of judgment	***No***

Madagascar is assessed at low risk of external debt distress. This marks a change from moderate risk in the June 2018 DSA, despite a broader definition of external debt, and reflects an upgrade in Madagascar's debt carrying capacity rather than a change in the debt path. Under the baseline, external public and publicly guaranteed (PPG) debt is well below applicable thresholds. Stress tests do not breach the threshold applicable to countries with medium debt-carrying capacity. Total (external plus domestic) PPG debt is below the benchmark under the baseline, but growth shocks drive the present value of the ratio of debt to GDP above the benchmark. Shocks could also introduce liquidity problems, as the debt-service to revenue ratio could exceed 100 percent over the long term. The overall rating, of moderate debt distress, remains consistent with the 2018 DSA. These assessments continue to be supportive of Madagascar's current plans to scale up its borrowing to meet its investment needs, though other factors are also critical.

[1] Prepared by the IMF and the World Bank. This DSA follows the Guidance Note of the Join Bank-Fund Debt Sustainability Framework for Low Income Countries, February 2018. This new framework builds on the 2013 framework used for the previous Madagascar DSA, which was published in June 2018 (IMF Country Report No. 18/239).

PUBLIC DEBT COVERAGE

1. **This DSA expands debt coverage of public and publicly guaranteed external and domestic debt to include State-owned Enterprises' domestic debt as well as central bank external liabilities.** This marks expanded coverage since the previous DSA (Text Table 1). PPG debt now includes all external liabilities held by the central bank (4 per-cent of GDP in 2018) including all borrowing from the IMF. Following recently-secured historical estimates, we now include debts owed by state-owned enterprises (SOEs) in cases where the government has at least 50 percent of the shares. These debts, which amount to an estimated 6 percent of GDP and are mostly those of the utility Jirama, are in addition to the coverage of direct guarantees provided by the central government. The DSA does not include the debt of local government owing primarily to data limitations, although anecdotal discussion suggests borrowing typically does not occur at this level and should require centralized approval. The measure of debt is on a *gross* rather than *net* basis and the currency criterion is used to distinguish between domestic and external debt.[2]

Text Table 1. Madagascar: Public Debt Coverage Under the Baseline Scenario

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	X

Text Table 2. Madagascar: Coverage of the Contingent Liabilities' Stress Test

The country's coverage of public debt	The central government, central bank, government-guaranteed debt, non-guaranteed SOE debt		
	Default		Used for the analysis
Other elements of the general government not captured in 1.	0	percent of GDP	0.0
SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	2.0
PPP	35	percent of PPP stock	0.0
Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0
Total (2+3+4+5) (in percent of GDP)			7.0

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

[2] Locally-issued debt denominated in local currency held by non-residents and/or locally-issued debt denominated in foreign currency held by residents is likely insignificant. Owing to limitations in available data, the results would be the same if selecting the residency criterion.

2. The coverage assumed for contingent liabilities is a shock of 7 percent of GDP. This reflects the default setting for SOEs, while minimum allowed values are used for PPPs and financial markets (Text Table 2).

- Estimated debt for SOEs in which the government has a majority stake are included in the baseline as domestic debt. However, government recognition of some of those liabilities could require external financing. Other potential contingencies include future recapitalization of the postal savings scheme and the Madagascar Savings Fund (*Caisse d'Epargne de Madagascar, CEM*), which would likely amount to less than 1 per-cent of GDP. Following the recapitalization of Air Madagascar and its strategic partnership with Air Austral, no additional public support to Air Madagascar beyond the guarantee included in the baseline debt is expected, but an implicit government guarantee of future airline obligations is a risk.

- Exposures through PPPs are set to zero since, as per the World Bank's PPP database, PPPs comprise less than ½ percent of GDP. The authorities plan to develop more PPPs in future.

- The default minimum value of 5 percent is programmed for financial markets. Most banks are financially solid with deposits exceeding loans and majority foreign shareholders. Dollarization of deposits and credits is not pronounced, and banks' foreign assets generally exceed their foreign liabilities.

BACKGROUND

A. Recent Debt Revisions and Developments

3. PPG debt ratios are lower than at the start of the ECF program. Using the expanded definitions, total public debt rose to 48.4 percent of GDP in 2015 and declined to 45.7 percent in 2018, reflecting stronger revenue collection, rising nominal GDP growth, and an appreciating real effective exchange rate. PPG debt was broadly unchanged since 2017 (46 percent), with external PPG debt rising by 1 percent of GDP and domestic debt declining by 1.3 percent. The 2018 DSA projected debt of 35 percent of GDP for 2018; the higher value in this DSA is mostly accounted for by the now-expanded coverage (Table 1, Figure 1).

4. Private external and hence total debt estimates have been revised upwards, and debt service has been revised downwards. Staff sourced updated estimates for external private debt drawing on confidential mining sector information in its September 2018 mission. Previous external debt estimates were based in part on fast amortization rates. Slower historical and forecast debt service reflect information attained during the mission.[3] This has resulted in upward revisions to historical private debt levels. For example, estimates for 2018 stand at 27.5 percent of GDP, which is substantially higher than the 11.5 per-cent estimated in the 2018 DSA. Nonetheless, private debt data remains incomplete. The authorities are working to reduce debt data gaps as they improve various components of external sector statistics by drawing on IMF technical assistance. Total public and private external debt is estimated at 58 percent of GDP in 2018, compared to 37 percent in the 2018 DSA but down 3 percent of GDP since 2016.

[3] We also expanded coverage to include commercial banks (worth 0.6 percent of GDP in 2018).

Text Table 3. Madagascar: Breakdown of Total PPG Debt (2015-18)

Creditor	2015	2016	2017	2018
		Amount (US$m)		
Domestic debt, *of which:*	**1,689**	**1,682**	**1,827**	**1,763**
Securities inc. BTA, BTF, BTS[1]	370	526	719	726
Debt to the Central Bank	386	337	297	272
Arrears	346	210	146	71
Other inc. SOE debt	587	610	665	693
External debt, *of which:*	**2,816**	**2,845**	**3,262**	**3,549**
Multilateral	2,006	2,052	2,276	2,368
Paris Club	146	137	165	189
Non-Paris Club	356	324	290	308
Commercial & Gauranteed	25	23	83	204
External debt of the Central Bank	282	310	449	480
Total PPG debt	**4,505**	**4,528**	**5,089**	**5,312**
		Percent of GDP		
Domestic debt, *of which:*	**16.8**	**17.5**	**16.5**	**15.2**
Securities inc. BTA, BTF, BTS	4.2	5.5	6.5	6.3
Debt to the Central Bank	4.3	3.5	2.7	2.3
Arrears	3.9	2.2	1.3	0.6
Other inc. SOE debt	6.6	6.3	6.0	6.0
External debt, *of which:*	**31.7**	**29.6**	**29.5**	**30.5**
Multilateral	22.6	21.4	20.6	20.4
Paris Club	1.6	1.4	1.5	1.6
Non-Paris Club	4.0	3.4	2.6	2.6
Commercial & Gauranteed	0.3	0.2	0.7	1.8
External debt of the Central Bank	3.2	3.2	4.1	4.1
Total PPG debt	**48.4**	**47.1**	**46.0**	**45.7**
		Percent of total		
Domestic debt, *of which:*	**37.5**	**37.2**	**35.9**	**33.2**
Securities inc. BTA, BTF, BTS	8.2	11.6	14.1	13.7
Debt to the Central Bank	8.6	7.4	5.8	5.1
Arrears	7.7	4.6	2.9	1.3
Other inc. SOE debt	13.0	13.5	13.1	13.0
External debt, *of which:*	**62.5**	**62.8**	**64.1**	**66.8**
Multilateral	44.5	45.3	44.7	44.6
Paris Club	3.3	3.0	3.2	3.6
Non-Paris Club	7.9	7.1	5.7	5.8
Commercial & Gauranteed	0.5	0.5	1.6	3.8
External debt of the Central Bank	6.3	6.8	8.8	9.0
Total PPG debt	**100.0**	**100.0**	**100.0**	**100.0**

Sources: Malagasy authorities; and staff estimates.

[1]BTA are Treasury bills with less than one year maturity; BTF and BTS are Treasury bonds with maturity ranging from 1 to 3 years.

5. **External sources account for two-thirds of PPG debt** (text table 3). The contribution of external debt has been rising following Madagascar's re-engagement with the international community. Contributors to the rise are chiefly multilateral sources, IMF lending to the Central Bank, and commercial loans. As at end-2018, two-thirds of external debt is owed to multilateral creditors, in particular the World Bank and African Development Bank, on highly concessional terms including long maturities. Non-Paris club creditors account for 9 percent of external debt, which is a lower share than at the start of the program. Domestic debt declined in 2018, mostly due to continued progress in reducing arrears. Government securities are the largest category, followed by estimated debts of SOEs in which the government has a majority stake.

B. Macroeconomic Assumptions

6. DSA projections remain consistent with the authorities' plan to scale up much needed infrastructure investment, albeit at a slower pace than in the previous DSA.

- As per the authorities' plans, external project loans signed, being studied, or being negotiated amount to approximately $1.6 billion in nominal terms for 2018-19, compared with $1.4 billion planned in the 2018 DSA, reflecting more specific project proposals. This includes $0.5 billion already contracted in 2018, which is $0.4 billion less than the authorities' plans used for the 2018 DSA. The authorities' plans therefore entail an ambitious acceleration in contracting for 2019. In particular, projected external borrowing for 2019 is $1 billion in nominal terms and $0.6 billion in PV terms. In the first five months of the year, only one new loan worth $ 150 million was signed.

- Actual and planned disbursements lag loans contracted. Disbursements, worth $0.25 billion in nominal terms in 2018 (2 percent of GDP), were $0.1 billion lower than forecast in the 2018 DSA owing to weak execution. Staff's projections assume under execution relative to the authorities' plans. We assume an increase to almost $0.4 billion in 2019. Disbursements beyond 2019 introduce some catch up to account for lower-than-anticipated historical disbursements, but at a slower pace than the authorities' plans, with a lower peak, and with the scaled-up phase extending further into the medium term than in the 2018 DSA. The 2019-21 debt strategy document indicates financing assumptions broadly consistent with the 2018 DSA. Over the long term, we assume disbursements fall gradually as a share of GDP back to around the share forecast for 2019 (around 3 percent of GDP). Thus, the assumption is that Madagascar will continue to borrow over the long run for development but at a slower pace than the scaled-up pace envisaged for the medium term.

7. Changes in short- and medium-term macroeconomic assumptions since the DSA 2018 largely reflect observed outcomes for 2018 (text table 4)**.** GDP growth projections remain broadly unchanged. Lower inflation forecasts are in part attributable to lower than expected inflation in 2018. The non-interest current account deficit has been revised down over the short term as vanilla and mining proceeds have again exceeded expectations. Over the next 5 years, vanilla prices are now expected to fall by one third, contributing to a steeper decline in the current account balance compared to the 2018 DSA.[4] However, this is offset by upward revisions to short- and medium-run mining export volumes following private sector discussions, and the 2029 deficit remains similar to the 2018 DSA. The 2019 primary deficit[5] is lower than in the 2018 DSA, reflecting lower expenditure estimates following budget discussions with the authorities. Revenues are revised down over the medium term to reflect more conservative projections for tax revenue showing a steady but credible upward trend. Some budget grant disbursements have been postponed to 2019 and 2020. Since we continue to include only firm commitments to be conservative, the assumptions include a steep decline in budget grants in 2020 and again (to zero) thereafter. Thus, assumed (project and budget) grants decline substantially. Expenditure has been revised down over the short run mainly due to observed under execution of investment spending.

[4] This time frame is consistent with estimates of supply responses from elsewhere in the world, and the steeper reduction also prompts a downward revision to assumed vanilla production growth over the longer term.

[5] The primary deficit in the table includes foreign financed capital expenditure and grants, which are excluded from IMF program quantitative targets.

Text Table 4. Madagascar: Baseline Macroeconomic Assumptions for DSA

	2019		2020		2024		2029	
(In percent of GDP, unless otherwise indicated)	2018 DSA	new DSA	old DSA	new DSA	old DSA	new DSA	old DSA	new DSA
Real GDP growth (percent)	5.4	5.2	5.3	5.3	4.8	4.8	4.7	4.6
Inflation, average (percent)	7.2	6.7	6.3	6.3	5.5	5.0	5.2	5.0
Non-interest CA deficit	2.4	1.3	3.4	2.8	2.0	3.8	3.1	2.9
Primary deficit	3.6	1.3	4.4	3.5	2.0	4.5	1.2	2.4
Total revenues, excluding grants	12.5	12.5	13.0	12.6	14.3	13.7	15.3	14.5
Grants	2.7	3.9	1.4	2.4	1.4	0.9	1.2	0.7
Non-Interest Expenditure	18.8	17.7	18.8	18.5	17.7	19.1	17.7	17.6

Sources: Malagasy authorities, World Bank and IMF.

8. **Long-term assumptions introduce additional conservatism and incorporate base effects from 2018 outturns**. Since average GDP growth rates typically taper as countries grow, long-term GDP growth is projected to slow slightly towards 4¼ percent over the projection period. Risks from recurrent natural disasters are implicitly incorporated in the baseline. The non-interest current account deficit is projected at around 3 percent in 2029 and 2½ percent in 2039. This marks a flatter profile in the outer years than in the previous DSA, which had a deficit rising to 4 percent in 2038. This DSA has more conservative assumptions on exports, including mining (following updated information on project lifespans) and processing zone imports/exports (to assume a more moderate share of total trade). By the end of the projection period, this change is offset by lower imports compared to the 2018 DSA. Other current account flows are higher, in part due to higher base effects from 2017-8.[6] Project grants are revised downward slightly since some sources of support are contingent on the external debt distress rating. We have assumed a slightly lower nominal exchange rate depreciation in order to be consistent with a very small real appreciation each year, which is in line with guidance and other country experience. The primary fiscal deficit is estimated at around 2½ percent in 2029, which is higher than in the 2018 DSA. This primarily mostly reflects more cautious assumptions on revenue growth.

9. **This outlook remains subject to risks, many tilted to the downside.** Lower than projected public investment would reduce borrowing but weigh negatively on growth. Losses at SOEs could crowd out pro-growth priority spending, while insufficient progress in fighting corruption could harm confidence. Madagascar also remains highly vulnerable to long-run terms-of-trade variations from the baseline as well as short-term fluctuations. Key drivers of the terms of trade include prices for imports of oil as well as exports of vanilla, which could return to their long-run average faster than forecasts, and metals, which can be particularly susceptible to growth in key global economies. More generally, negative external developments, such as lower global growth, rising protectionism and a retreat from multilateralism, could reduce exports and donor assistance. At the same time, there are upside risks for growth, since projections are conservative on FDI and the multiplier effect from scaled-up public investment, and to the terms of trade. Revenue projections could prove unduly conservative.

[6] This revision also generates a smoother path for the residual between debt accumulation and identified debt creating flows, which fell abruptly to zero in the previous DSA.

C. Drivers of Debt Dynamics

10. Over the medium term, scaling up of foreign-financed public investment drives an increase in debt compared with the 5-year average (Figure 3). In 2014-8, external debt rose substantially slower than anticipated in the 2015 DSA. The difference is clearer when comparing the 2015 and 2018 vintages, since this DSA introduces an expanded definition of PPG debt. A key contributor is an unanticipated more than ten-fold rise in Vanilla prices, which boosted the current account and the Ariary. Following re-engagement with the international donor community and the IMF program in 2016, external debt is expected to rise, permitting imports to support much-needed investment. The expected pace of project execution has been revised down slightly relative to the 2018 DSA, leading to a marginally more gradual rise in external debt. Other contributors, such as FDI and a residual that includes unrepatriated mining receipts and reserve accumulation, remain broadly similar to recent history (and unchanged from the 2018 DSA). Public (domestic and external) debt changes were slightly less than those expected in the past, largely reflecting external debt developments. Debt is anticipated to rise slightly (and more slowly than in the past) as the higher primary deficit is almost offset by GDP growth.

11. Government capital spending accounts for much of the expected increase in growth compared to the past (Figure 4). Over the next three years, the primary deficit (including spending financed by external sources) is expected to rise, adding a positive impulse that sustains GDP growth despite the unwinding of the impulse from the 2018 agriculture recovery. The low implied fiscal multiplier may suggest upside risk to growth, as indicated earlier. The contribution of public investment to real GDP growth is expected to be higher than in recent history but lower than in the previous DSA. This reflects the slower-than-anticipated scaling up of private investment, which nonetheless could again be slower than forecast.

D. Country Classification and Determination of Stress Test Scenarios

12. Madagascar's composite indicator has risen and is above the threshold to classify its debt carrying capacity as medium. The upgrade is consistent with incremental progress recorded in the December 2017 World Bank Debt Performance Assessment and summarized in the 2018 DSA. For that DSA, Madagascar had a CPIA[7] score of 3.17, which reflected recent steady improvements but was below the threshold of 3.25 needed for graduation from weak to medium debt-carrying capacity. The CPIA has since risen again. Moreover, the new DSA framework complements the CPIA with import cover of reserves, remittances, Madagascar's real GDP growth, and world GDP growth to form a Composite Indicator (CI) score. The calculation of the CI is based on 10-year averages across 5 years of historical data and 5 years of projection. The April 2019 WEO constitutes a repeated signal to upgrade of the country from weak to medium debt-carrying capacity (Text Table 5). Contributors to debt-carrying capacity should be carefully monitored. Reserves account for the bulk of the increase since the October 2018 WEO. Substantial downward revisions to medium-term reserves projections or global growth alongside reversal of debt-carrying capacity progress could bring Madagascar's CI score closer to the lower threshold.

[7] The Country Policy and Institutional Assessment (CPIA) is an index compiled annually by the World Bank for all IDA-eligible countries. It consists of 16 indicators in four categories: (1) economic management; (2) structural policies; (3) policies for social inclusion and equity; and (4) public sector management and institutions.

Text Table 5. Madagascar: Calculation of Debt-Carrying Capacity

	DSA June 2018	WEO October 2018	WEO April 2019
CPIA 1/	1.22	1.24	1.24
Real growth rate (in percent)		0.12	0.12
Import coverage of reserves (in percent)		0.86	0.91
Remittances (in percent)		0.05	0.05
World economic growth (in percent)		0.48	0.48
Composite Indicator Score		2.75	2.80
Debt Carrying Capacity 2/	**Weak**	**Medium**	**Medium**

1/ CPIA score for June 2018 DSA of 3.17 based on 2014-16 average and rescaled for comparison.

2/ Unscaled CPIA Threshold to reach medium capacity was 3.25 and Composite Indicator Score Threshold for medium capacity is 2.69.

13. The improvement in debt-carrying capacity classification implies an increase in thresholds for debt burdens. For the present value (PV) of external debt relative to GDP, thresholds rise from 30 to 40 percent. Relative to exports, the threshold rises from 140 to 180 percent. The threshold for the PV of external debt service increases from 10 to 15 percent for exports, and from 14 to 18 percent for revenue. The benchmark for the PV of total public debt also rises from 35 to 55 percent of GDP.

14. Stress tests generally follow standardized settings and include shocks for natural disasters and commodity export prices. The contingent liability stress test is based on the quantification of potential contingent liabilities discussed above, and the standardized stress tests apply the default settings. Madagascar remains exposed and vulnerable to natural disaster shocks, like cyclones, and hence qualifies for the natural disaster shock.[8] Since commodities comprise about half of goods and services exports, we also include a commodity shock stress test. The standardized settings of this stress test are customized to better reflect Madagascar's country specific circumstances. In particular, we assume an illustrative fall in prices equivalent to 10 percent of commodity exports, with no mitigating effect on imports, alongside declines in real GDP growth of 0.5 percent and in fiscal revenue of 0.25 percent of GDP. The shock occurs in 2020 and unwinds gradually by 2029. Residual financing for external debt stress tests is assumed to be from external sources at the baseline concessional rates, which is the default setting. For overall public debt stress tests, limited recourse to domestic sources in the short run prompts us to assume 80 percent of additional financing would come from external sources and that the remaining domestic financing would be more expensive than under the baseline.

[8] We apply the default settings for this one-off shock in the template, namely a 10 percentage-point rise in the debt-to-GDP ratio alongside a fall in real GDP growth (1.5 percent) and exports (3.5 percent), in 2020.

DEBT SUSTAINABILITY RESULTS

A. External Debt Sustainability

15. Under the baseline, rising external PPG debt remains comfortably below thresholds (Table 1). It is projected to rise from 30½ percent of GDP in 2018 to 43 percent of GDP in 2029 and decline to about 38 percent of GDP in 2039. The profile using the expanded definition is similar to that in the 2018 DSA, which had external debt rising to 36 percent in 2028 and falling to 32 percent in 2038. Debt-creating flows include a steadily rising current account deficit over the medium term (owing to declines in the trade balance and falling inflows from official transfers) and slightly weaker endogenous debt dynamics (higher interest rates and slowing GDP growth).[9] In present value terms, external debt is projected to rise from 18 percent of GDP in 2018 to almost 30 percent of GDP in 2029 and 27 percent by 2039. The higher relative long-term rise in PV terms is the result of our assumption that borrowing will become less concessional over the long term, reflecting assumed rises in interest rates and a less favorable mix of concessional lenders. Together with expiring grace periods for some loans, this explains why debt service indicators rise substantially off their low base. For example, the projected debt service to exports ratio rises from 2½ in 2018 to 6 in 2029. Nonetheless, all indicators remain well below the applicable thresholds for Madagascar.

16. None of the shock scenarios breach the external thresholds applied for Madagascar by 2029 but would breach or come close to the thresholds for those with weak capacity (Table 3; Figure 1). The most serious shock is that to export growth, which is set to one standard deviation of the projection or historical average (whichever yields lower exports) in 2020 and 2021. Using the applicable thresholds for Madagascar for medium debt carrying capacity, the most serious shock does not breach any of the four thresholds, although the debt-service-to-revenue ratio peaks at about 17, which is close to the threshold of 18 and above the threshold of 14 for weak capacity countries. The PV of debt to GDP rises to 38 percent of GDP in 2025 and remains near 37 percent in 2029, below the indicated threshold of 40 applicable to Madagascar (but above the threshold of 30 that would apply for those with weak capacity). The same shock would drive the PV of debt-to-exports ratio to about 160, which is below the threshold of 180 for Madagascar but above the weak-capacity threshold, and push the debt-service to exports ratio to 11, which is below Madagascar's threshold of 15 but above the weak-capacity threshold of 10.

17. The historical scenarios and granularity of assessment are less applicable to Madagascar. The historical scenario shows the PV of debt to GDP exceeding 40 in 2029 but, as discussed in the 2017 DSA, is currently not a useful stress test or measure of realism since it includes data with atypically high current account deficits related to private mining investment.[10] For countries that breach external debt thresholds, further granularity can be provided by assessing the gap between baseline debt projections and the threshold between moderate and high debt distress. This is not the case for Madagascar given its low risk of debt distress. However, illustrative calculations applying lower thresholds that would be associated with

[9] The residual, which includes reserve accumulation, unrepatriated mining receipts, and potentially other misclassified BOP entries, is assumed to decline steadily over time as the share of mining exports declines and reserve accumulation slows.

[10] For example, excluding 2009 and 2010 from the calculation halves the historical non-interest current account deficit (over the last eight years) to 2½ percent.

countries of a lower debt carrying capacity indicate that, for the PV of debt to GDP and of debt service to revenue, Madagascar's baseline debt burden places it in the zone of having limited space to absorb shocks.[11]

18. Private sector debt is not assessed to pose a significant threat to external sustainability. Private external debt is projected to decline as the loans related to a major mining project are repaid. Using improved information on financial plans, including on mining, the share of private external debt in GDP is anticipated to fall by half within the next decade. Given the exceptional nature of the mining projects, the DSA does not forecast substantial new external borrowing from the private sector over the corresponding period. However, since the 2018 DSA, we have conservatively assumed more borrowing would be needed to sustain mining exports towards the end of the DSA horizon, contributing to private debt equivalent to about 10 percent of GDP in 2039. Such debt is not assessed to pose a significant threat to external sustainability. Consistent with recent experience leading to slower amortization, the ultimate liability for these loans is held by the multinational shareholders rather than resident entities (such as domestic banks or the government).

B. Total Public Debt Sustainability

19. Under the baseline, moderate rises in total domestic and external public debt remain comfortable (Table 2). Total debt is projected to rise from 45½ percent of GDP in 2018 to 57 percent of GDP in 2029 and remain steady thereafter. In the 2018 DSA, which excluded external debts of the central bank and domestic SOE debt, total debt was projected at 44 percent of GDP in 2028 and 2038. The domestic component is projected to decline from 15 percent of GDP in 2018 to 14 percent in 2029 and rise above 18 percent by 2039, reflecting increasing reliance on domestic financing as the sector develops and external support becomes less essential. In PV terms, total debt as a share of GDP rises from 33½ percent in 2018 to a projected 43½ percent in 2029 and 46 percent in 2039, remaining below the threshold of 55 percent for medium-capacity countries including Madagascar. The PV of debt to revenue and grants rises more moderately since the share of tax revenue in GDP is projected to continue rising off its low base. Despite this, and consistent with a shift to less concessional external financing sources and from external to more expensive domestic financing, the rise in debt service to revenue and grants increases toward the end of the projection horizon.

20. Total public debt is vulnerable to growth shocks and commodity prices (Figure 2; Table 4). The most severe test is the simulated GDP shock, where growth in 2020 and 2021 is one standard deviation lower than its historical average or the forecast (whichever yields lower GDP). For this shock, the PV of debt to GDP exceeds 55 percent of GDP by 2024, reaches 66 percent of GDP in 2029, and keeps rising. The threshold for medium-capacity countries like Madagascar is 55. Moreover, such a shock would also result in a debt service to revenue ratio above 90 percent before 2029 (and above 100 in the 2030s). Although there is no mechanical threshold, these ratios point to potentially severe debt service difficulties in the long run if no action to contain borrowing is taken soon after the shock. The assumed commodity shock would also breach the threshold for the PV of debt to GDP, reaching 64 percent in 2029, and raise the debt service to revenue ratio to 82 in the same year. An export shock, a natural disaster shock, or the contingent liability shock would also increase total public debt burdens.

[11] For example, for a threshold of 30 for the PV of debt to GDP, countries' whose baseline debt exceeds 24 under the baseline are assessed as having limited space. Madagascar's baseline PV exceeds that value over the medium term.

RISK RATING AND VULNERABILITIES

21. Madagascar is classified as being at low risk of external debt distress. Under the baseline, no thresholds are breached. Stress tests produce no breaches of the higher thresholds that apply following Madagascar's upgraded capacity to carry debt, although a shock to exports typically has the biggest effect on external PPG debt sustainability indicators and comes close. There are multiple breaches of the lower thresholds for countries with weak capacity.

22. The overall assessment is that Madagascar is at moderate risk of debt distress. Overall PPG debt stress tests, including to GDP growth and export commodity prices, breach the applicable threshold for the PV of debt to GDP as soon as 2024 and the ratio continues to rise. Together with high debt service burdens and Madagascar's relatively recent debt-carrying capacity upgrade, this prompts staff to assess Madagascar's overall risk of debt distress as moderate.

23. These assessments continue to be supportive of Madagascar's current plans to scale up its borrowing to meet its investment needs, though other factors are also critical. A steep increase in borrowing in line with a rapid execution of the government's ambitious medium-term borrowing plan would carry significant risks. There are countries in the region that have experienced sharp deterioration in their external debt distress rating from low to high within a short period of time. In addition to debt sustainability, other crucial considerations for the pace of borrowing include the economy's general absorptive capacity, public financial management, and public investment management.

24. Relevant factors that could affect future assessments include data revisions and the speed of realization of borrowing plans. Staff have assumed a slower pace of project disbursement than the authorities. Further shortfalls in disbursements on borrowing or alternatively more ambitious borrowing plans beyond the medium term would affect the debt profile. The state of SOE liabilities could also influence future assessments. Less grant financing and a switch to a less concessional mix of borrowing would raise the debt burden, especially when measured in PV terms, as well as debt service risks. Rebased (higher) GDP data is expected to be incorporated in the macroeconomic framework in the near future,[12] while efforts to enhance external statistics could improve private debt coverage. Madagascar's ability to preserve and build on its debt-carrying capacity is also important.

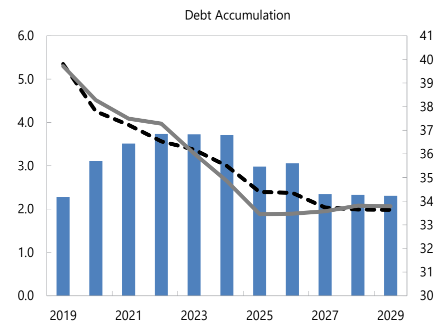
[12] New data according to the 1993 System of National Accounts (SNA93) with 2007 as the base year will be used by the authorities starting with the preparation of the 2020 budget. The rebased GDP in nominal terms is about 16 percent higher for the 2007-2017 period.

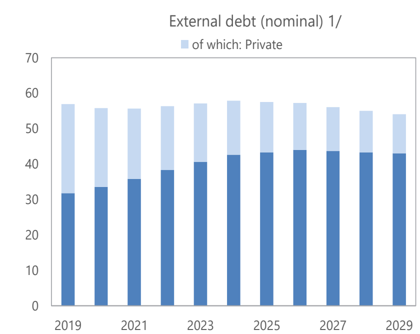
Table 1. Madagascar: External Debt Sustainability Framework, Baseline Scenario, 2016-2039

(In percent of GDP; unless otherwise indicated)

	Actual			Projections								Average 8/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
External debt (nominal) 1/	**59.7**	**57.7**	**58.0**	**56.9**	**55.8**	**55.6**	**56.3**	**57.1**	**57.9**	**54.1**	**46.9**	**45.6**	**56.3**
of which: public and publicly guaranteed (PPG)	**29.6**	**29.5**	**30.5**	**31.8**	**33.6**	**35.8**	**38.3**	**40.6**	**42.6**	**43.0**	**37.8**	**28.7**	**40.0**
Change in external debt	-2.1	-2.0	0.3	-1.1	-1.1	-0.2	0.7	0.8	0.8	-0.9	-0.8		
Identified net debt-creating flows	**-7.6**	**-9.6**	**-7.9**	**-4.3**	**-2.5**	**-1.5**	**-1.1**	**-0.8**	**-0.8**	**-1.3**	**-1.3**	**-0.7**	**-1.6**
Non-interest current account deficit	**-1.0**	**0.0**	**-1.4**	**1.3**	**2.8**	**3.5**	**3.7**	**3.9**	**3.8**	**2.9**	**2.6**	**5.2**	**3.1**
Deficit in balance of goods and services	2.2	3.8	3.9	6.2	6.3	7.2	7.6	8.0	8.2	7.4	7.0	**8.9**	**7.4**
Exports	33.1	35.5	36.0	34.7	34.8	34.0	33.4	32.9	32.5	30.2	26.9		
Imports	35.3	39.4	40.0	40.9	41.1	41.2	41.0	40.9	40.7	37.6	34.0		
Net current transfers (negative = inflow)	-6.8	-6.4	-8.0	-7.1	-5.5	-5.4	-5.4	-5.5	-5.6	-5.3	-4.9	**-6.2**	**-5.6**
of which: official	-3.4	-2.8	-3.0	-3.9	-2.4	-1.9	-1.4	-1.2	-0.9	-0.7	-0.6		
Other current account flows (negative = net inflow)	3.6	2.6	2.7	2.2	1.9	1.7	1.5	1.3	1.2	0.8	0.4	**2.5**	**1.3**
Net FDI (negative = inflow)	**-4.5**	**-3.1**	**-4.1**	**-3.2**	**-3.2**	**-3.1**	**-3.1**	**-3.1**	**-3.1**	**-3.1**	**-3.1**	**-5.2**	**-3.1**
Endogenous debt dynamics 2/	**-2.2**	**-6.5**	**-2.4**	**-2.3**	**-2.1**	**-1.9**	**-1.7**	**-1.6**	**-1.5**	**-1.1**	**-0.8**		
Contribution from nominal interest rate	0.4	0.4	0.6	0.6	0.7	0.7	0.8	0.9	1.0	1.2	1.1		
Contribution from real GDP growth	-2.5	-2.3	-2.8	-2.9	-2.8	-2.7	-2.5	-2.5	-2.5	-2.3	-1.9		
Contribution from price and exchange rate changes	-0.1	-4.7	-0.1	...	...	...	...	...	...	...	...		
Residual 3/	**5.5**	**7.6**	**8.3**	**3.2**	**1.4**	**1.4**	**1.8**	**1.6**	**1.6**	**0.4**	**0.5**	**3.7**	**1.2**
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		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	**...**	**...**	**18.1**	**19.6**	**20.9**	**22.6**	**24.4**	**26.1**	**27.7**	**29.6**	**27.2**		
PV of PPG external debt-to-exports ratio	**...**	**...**	**50.2**	**56.5**	**60.1**	**66.4**	**73.2**	**79.5**	**85.1**	**98.1**	**101.0**		
PPG debt service-to-exports ratio	**3.1**	**5.6**	**2.6**	**2.6**	**3.0**	**3.4**	**3.9**	**4.7**	**5.0**	**5.9**	**7.8**		
PPG debt service-to-revenue ratio	**9.3**	**16.7**	**7.9**	**7.1**	**8.3**	**8.8**	**9.9**	**11.6**	**11.9**	**12.3**	**14.0**		
Gross external financing need (Million of U.S. dollars)	-425.0	12.5	-487.0	292.9	523.3	668.7	764.7	850.4	863.6	862.3	1470.3		
Key macroeconomic assumptions													
Real GDP growth (in percent)	4.2	4.3	5.2	5.2	5.3	5.1	4.9	4.8	4.8	4.6	4.3	**2.3**	**4.9**
GDP deflator in US dollar terms (change in percent)	0.2	8.6	0.3	-1.3	3.3	2.8	2.7	2.8	2.8	2.8	2.8	**0.5**	**2.5**
Effective interest rate (percent) 4/	0.7	0.8	1.1	1.1	1.3	1.5	1.6	1.8	2.0	2.4	2.6	**0.9**	**1.9**
Growth of exports of G&S (US dollar terms, in percent)	7.2	21.6	7.0	0.0	9.0	5.7	5.7	6.2	6.6	6.0	6.0	**6.3**	**5.7**
Growth of imports of G&S (US dollar terms, in percent)	3.3	26.2	7.1	6.3	9.3	8.3	7.2	7.5	7.3	6.4	6.2	**0.9**	**6.9**
Grant element of new public sector borrowing (in percent)	...	...	...	39.7	38.3	37.5	37.3	36.0	34.8	33.8	33.4	**...**	**35.6**
Government revenues (excluding grants, in percent of GDP)	11.1	11.9	12.0	12.5	12.6	12.9	13.1	13.4	13.7	14.5	15.1	**10.6**	**13.6**
Aid flows (in Million of US dollars) 5/	606.2	606.6	634.9	758.8	828.6	903.2	954.9	1013.1	999.1	1062.5	1796.3		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	5.3	4.3	3.9	3.6	3.4	3.0	2.0	1.7	**...**	**3.1**
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	70.7	58.5	53.5	49.0	46.6	43.7	43.6	43.6	**...**	**49.0**
Nominal GDP (Million of US dollars)	10,126	11,464	12,090	12,559	13,662	14,765	15,901	17,132	18,457	26,646	54,259		
Nominal dollar GDP growth	4.4	13.2	5.5	3.9	8.8	8.1	7.7	7.7	7.7	7.5	7.2	**2.8**	**7.5**
Memorandum items:													
PV of external debt 7/	...	...	45.6	44.8	43.1	42.4	42.5	42.6	43.0	40.6	36.3		
In percent of exports	...	...	126.4	129.0	124.1	124.8	127.2	129.6	132.0	134.7	134.8		
Total external debt service-to-exports ratio	3.8	9.0	4.1	12.3	12.1	12.3	12.6	12.8	12.2	11.3	12.0		
PV of PPG external debt (in Million of US dollars)			2186.9	2462.9	2854.3	3334.1	3885.9	4477.9	5113.1	7880.9	14769.8		
(PVt-PVt-1)/GDPt-1 (in percent)				2.3	3.1	3.5	3.7	3.7	3.7	2.3	1.5		
Non-interest current account deficit that stabilizes debt ratio	1.1	2.1	-1.7	2.4	3.9	3.7	3.0	3.1	3.0	3.8	3.4		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**





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

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

6/ 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).

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

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

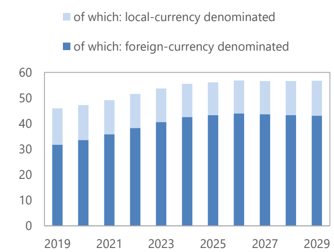
Table 2. Madagascar: Public Sector Debt Sustainability Framework, Baseline Scenario, 2016-2039

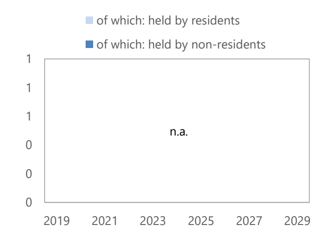
(In percent of GDP; unless otherwise indicated)

	Actual			Projections								Average 6/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
Public sector debt 1/	**47.1**	**46.0**	**45.7**	**46.0**	**47.2**	**49.2**	**51.6**	**53.7**	**55.6**	**56.8**	**56.1**	**42.3**	**53.3**
of which: external debt	**29.6**	**29.5**	**30.5**	**31.8**	**33.6**	**35.8**	**38.3**	**40.6**	**42.6**	**43.0**	**37.8**	**28.7**	**40.0**
Change in public sector debt	-3.5	-1.1	-0.3	0.3	1.3	2.0	2.4	2.1	1.8	0.1	-0.4		
Identified debt-creating flows	**-3.9**	**-3.8**	**-2.4**	**-0.9**	**1.1**	**1.9**	**2.5**	**2.4**	**2.1**	**0.1**	**-0.4**	**-0.2**	**1.0**
Primary deficit	**0.4**	**1.6**	**0.6**	**1.3**	**3.5**	**4.3**	**4.7**	**4.7**	**4.5**	**2.4**	**1.5**	**1.6**	**3.4**
Revenue and grants	14.6	14.8	14.8	16.4	15.0	14.8	14.4	14.6	14.6	15.2	15.7	**12.7**	**15.0**
of which: grants	3.4	2.9	2.8	3.9	2.4	1.9	1.4	1.2	0.9	0.7	0.6		
Primary (noninterest) expenditure	15.0	16.4	15.5	17.7	18.5	19.1	19.2	19.3	19.1	17.6	17.2	**14.2**	**18.4**
Automatic debt dynamics	**-4.3**	**-5.4**	**-3.0**	**-2.9**	**-3.0**	**-2.9**	**-2.8**	**-2.8**	**-2.9**	**-2.8**	**-2.4**		
Contribution from interest rate/growth differential	-3.6	-3.2	-3.7	-2.9	-2.8	-2.6	-2.4	-2.5	-2.6	-2.5	-2.2		
of which: contribution from average real interest rate	-1.5	-1.3	-1.4	-0.7	-0.4	-0.3	-0.2	-0.2	-0.2	-0.1	0.2		
of which: contribution from real GDP growth	-2.0	-1.9	-2.3	-2.3	-2.3	-2.3	-2.3	-2.4	-2.5	-2.5	-2.3		
Contribution from real exchange rate depreciation	-0.7	-2.2	0.7	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.6**	**0.6**	**0.6**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.0**	**0.5**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.5		
Residual	**0.4**	**2.7**	**2.1**	**1.2**	**-0.1**	**-0.3**	**-0.4**	**-0.5**	**-0.6**	**-0.3**	**-0.3**	**2.0**	**-0.2**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**34.0**	**34.1**	**34.9**	**36.3**	**38.0**	**39.5**	**40.9**	**43.6**	**45.8**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**229.5**	**208.2**	**232.7**	**244.7**	**263.2**	**270.7**	**280.2**	**287.2**	**292.0**		
Debt service-to-revenue and grants ratio 3/	**7.0**	**7.0**	**43.5**	**39.4**	**45.6**	**51.6**	**56.2**	**59.9**	**62.0**	**70.0**	**96.7**		
Gross financing need 4/	1.5	2.7	7.1	8.9	11.1	12.6	13.4	14.0	14.1	13.6	17.2		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	4.2	4.3	5.2	5.2	5.3	5.1	4.9	4.8	4.8	4.6	4.3	**2.3**	**4.9**
Average nominal interest rate on external debt (in percent)	0.8	0.9	1.1	1.1	1.4	1.4	1.4	1.5	1.5	1.6	1.6	**0.7**	**1.5**
Average real interest rate on domestic debt (in percent)	-7.8	-6.1	-6.8	-3.7	-1.6	-0.8	0.1	0.2	0.1	1.0	1.9	**-6.7**	**-0.2**
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.5	-7.7	2.4	...	...	...	...	...	...	...	...	**1.1**	**...**
Inflation rate (GDP deflator, in percent)	8.5	6.5	7.3	6.7	6.3	5.8	5.2	5.0	5.0	5.0	5.0	**7.2**	**5.3**
Growth of real primary spending (deflated by GDP deflator, in percent)	8.5	14.0	-0.7	20.5	10.3	8.4	5.2	5.4	4.0	4.7	3.3	**1.9**	**6.3**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	3.9	2.7	0.9	1.1	2.3	2.3	2.3	2.5	2.7	2.4	1.9	**2.5**	**2.4**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt, non-guaranteed SOE debt . Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

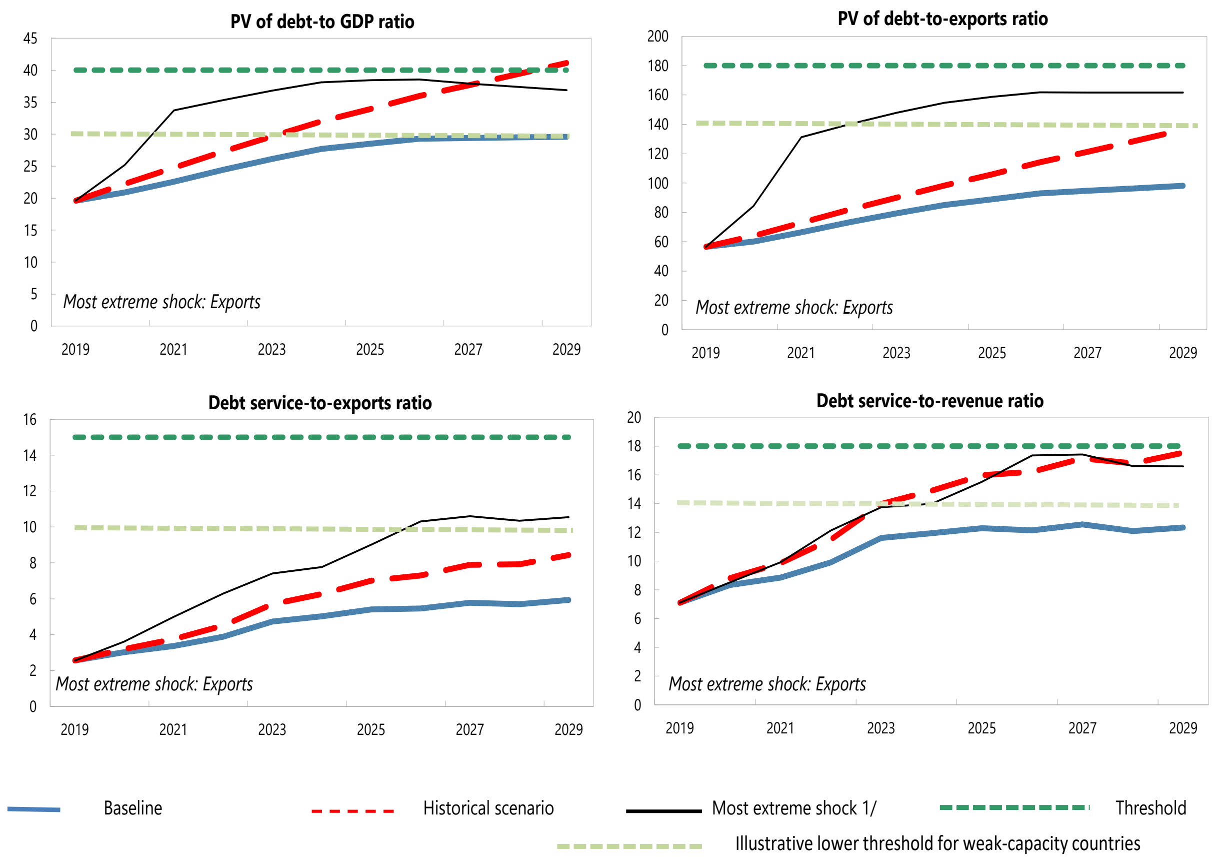
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ 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 and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 1. Madagascar: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2019-2029



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	No	No
Commodity price	Yes	Yes
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

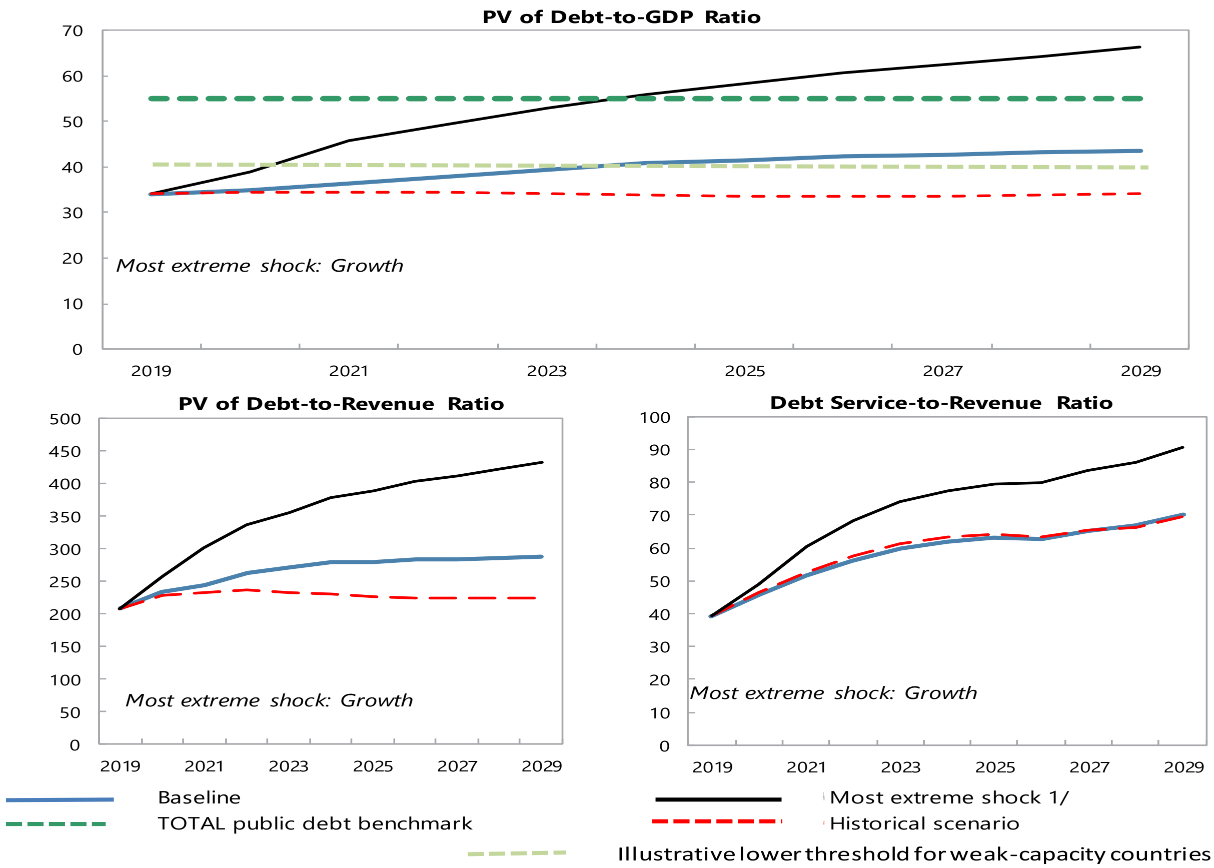
Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.6%	1.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	26	26
Avg. grace period	4	4

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Madagascar: Indicators of Public Debt Under Alternative Scenarios, 2019-2029



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	38%	80%
Domestic medium and long-term	13%	10%
Domestic short-term	48%	10%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.6%	1.6%
Avg. maturity (incl. grace period)	26	26
Avg. grace period	4	4
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.7%	3.5%
Avg. maturity (incl. grace period)	2	2
Avg. grace period	1	1
Domestic short-term debt		
Avg. real interest rate	2.1%	3.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Madagascar: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2019-2029

(In percent)

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to GDP ratio											
Baseline	20	21	23	24	26	28	28	29	29	29	30
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	20	22	25	27	30	32	34	36	38	39	**41**
B. Bound Tests											
B1. Real GDP growth	20	23	27	29	31	33	34	35	35	35	35
B2. Primary balance	20	21	23	25	27	28	29	30	30	30	30
B3. Exports	20	25	34	35	37	38	38	39	38	37	37
B4. Other flows 3/	20	23	26	28	30	31	32	32	32	32	32
B5. Depreciation	20	26	26	28	30	32	33	35	35	35	35
B6. Combination of B1-B5	20	27	31	33	35	37	37	38	38	38	38
C. Tailored Tests											
C1. Combined contingent liabilities	20	24	26	28	30	31	32	33	33	33	33
C2. Natural disaster	20	26	28	31	32	34	35	35	35	36	36
C3. Commodity price	20	22	24	26	28	29	30	30	30	30	30
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	57	60	66	73	79	85	89	93	95	96	98
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	57	64	73	82	90	98	106	114	121	129	136
B. Bound Tests											
B1. Real GDP growth	57	60	66	73	79	85	89	93	95	96	98
B2. Primary balance	57	61	68	75	82	87	91	95	97	98	100
B3. Exports	57	84	131	140	148	155	159	162	162	162	162
B4. Other flows 3/	57	66	78	85	91	96	99	103	104	105	106
B5. Depreciation	57	60	60	67	73	79	83	88	90	92	94
B6. Combination of B1-B5	57	78	77	99	106	113	116	120	121	123	124
C. Tailored Tests											
C1. Combined contingent liabilities	57	70	77	84	91	96	100	104	105	107	108
C2. Natural disaster	57	77	85	94	100	106	110	115	117	118	120
C3. Commodity price	57	63	72	79	85	90	94	97	99	100	101
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	3	3	3	4	5	5	5	5	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	3	3	4	5	6	6	7	7	8	8	8
B. Bound Tests											
B1. Real GDP growth	3	3	3	4	5	5	5	5	6	6	6
B2. Primary balance	3	3	3	4	5	5	5	6	6	6	6
B3. Exports	3	4	5	6	7	8	9	10	11	10	11
B4. Other flows 3/	3	3	3	4	5	5	6	6	7	6	7
B5. Depreciation	3	3	3	4	5	5	5	5	5	5	6
B6. Combination of B1-B5	3	3	4	5	6	6	7	7	8	8	8
C. Tailored Tests											
C1. Combined contingent liabilities	3	3	4	4	5	5	6	6	6	6	6
C2. Natural disaster	3	3	4	4	5	6	6	6	6	6	7
C3. Commodity price	3	3	3	4	5	5	6	6	6	6	6
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	7	8	9	10	12	12	12	12	13	12	12
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	7	9	10	11	14	15	16	16	17	17	18
B. Bound Tests											
B1. Real GDP growth	7	9	11	12	14	14	15	14	15	14	15
B2. Primary balance	7	8	9	10	12	12	12	12	13	12	13
B3. Exports	7	9	10	12	14	14	16	17	17	17	17
B4. Other flows 3/	7	8	9	11	12	13	13	14	14	14	14
B5. Depreciation	7	10	11	12	14	15	15	14	15	14	14
B6. Combination of B1-B5	7	9	11	13	14	15	17	16	17	16	16
C. Tailored Tests											
C1. Combined contingent liabilities	7	8	9	11	12	13	13	13	13	13	13
C2. Natural disaster	7	8	10	11	13	13	13	13	13	13	13
C3. Commodity price	7	9	9	10	12	13	13	13	13	13	13
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

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

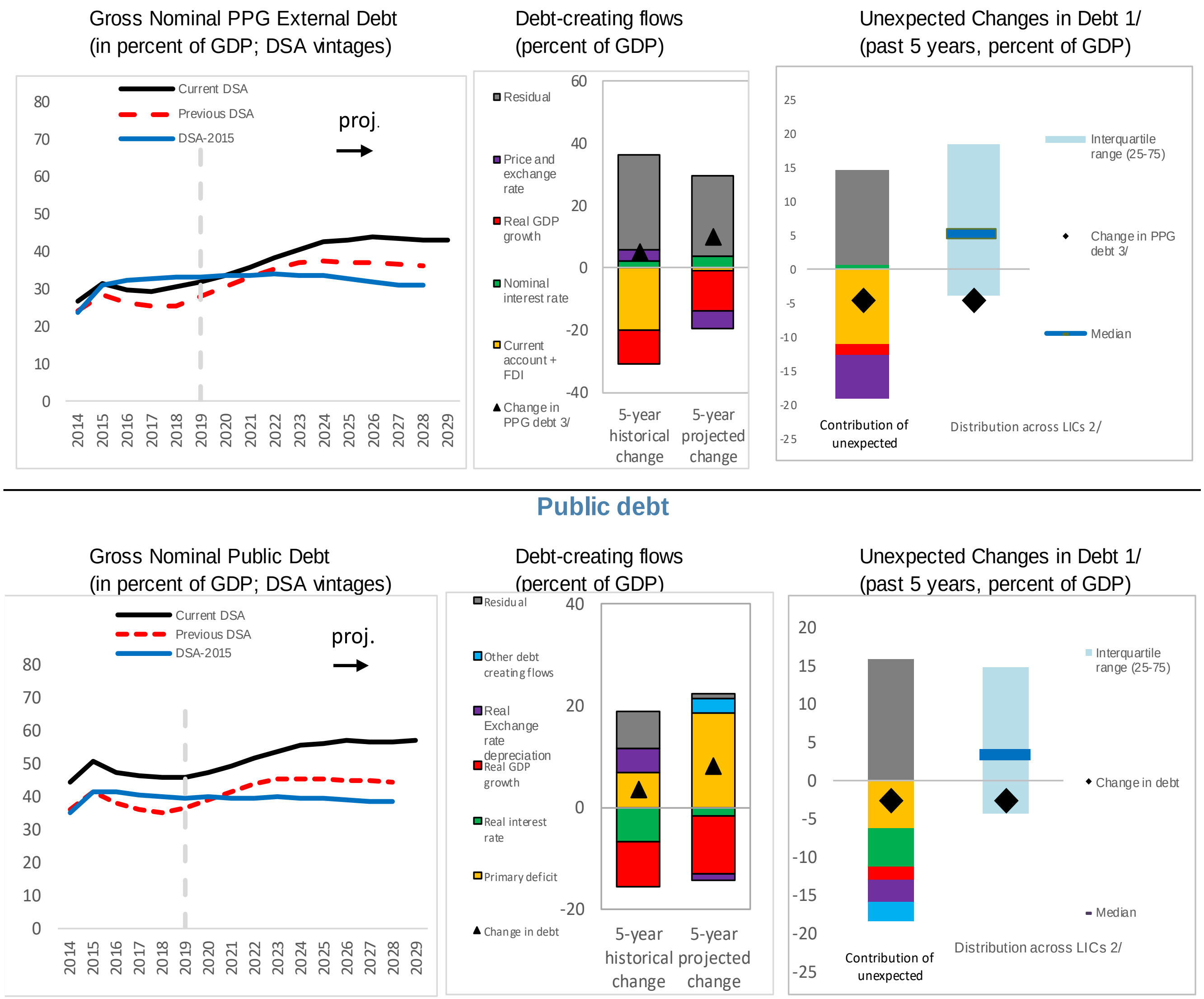
3/ Includes official and private transfers and FDI.

Table 4. Madagascar: Sensitivity Analysis for Key Indicators of Public Debt, 2019-2029

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of Debt-to-GDP Ratio											
Baseline	34	35	36	38	40	41	42	42	43	43	44
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	34	34	34	34	34	34	34	34	34	34	34
B. Bound Tests											
B1. Real GDP growth	34	39	46	50	53	**56**	**58**	**61**	**62**	**64**	**66**
B2. Primary balance	34	36	38	39	41	42	43	44	44	44	44
B3. Exports	34	39	46	48	49	50	50	50	50	50	49
B4. Other flows 3/	34	37	40	42	43	45	45	46	45	46	46
B5. Depreciation	34	38	38	38	38	38	38	38	37	37	37
B6. Combination of B1-B5	34	36	39	41	42	44	45	45	46	46	47
C. Tailored Tests											
C1. Combined contingent liabilities	34	40	41	42	44	45	46	46	46	47	47
C2. Natural disaster	34	43	44	45	47	48	49	49	50	50	50
C3. Commodity price	34	37	41	45	49	53	**55**	**58**	**60**	**62**	**64**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	208	233	245	263	271	280	280	285	285	286	287
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	208	229	232	237	233	231	226	224	223	224	225
B. Bound Tests											
B1. Real GDP growth	208	257	302	337	357	379	389	404	413	423	433
B2. Primary balance	208	238	255	273	280	289	288	292	291	292	293
B3. Exports	208	258	311	329	334	341	337	336	331	328	325
B4. Other flows 3/	208	246	271	290	296	305	303	305	303	302	302
B5. Depreciation	208	257	257	264	261	261	254	253	248	245	243
B6. Combination of B1-B5	208	239	259	281	289	300	300	304	304	305	306
C. Tailored Tests											
C1. Combined contingent liabilities	208	268	277	294	300	308	307	310	309	309	310
C2. Natural disaster	208	286	296	313	319	328	327	331	330	330	331
C3. Commodity price	208	248	279	317	340	364	375	388	398	408	419
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	39	46	52	56	60	62	63	63	65	67	70
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	39	46	53	58	61	64	64	63	65	66	69
B. Bound Tests											
B1. Real GDP growth	39	49	60	68	74	77	79	80	84	86	91
B2. Primary balance	39	46	52	58	61	62	63	63	66	67	70
B3. Exports	39	46	52	58	61	63	66	67	69	70	73
B4. Other flows 3/	39	46	52	57	60	63	64	64	67	68	71
B5. Depreciation	39	44	50	55	59	61	62	61	63	65	67
B6. Combination of B1-B5	39	46	53	58	63	65	66	66	69	70	74
C. Tailored Tests											
C1. Combined contingent liabilities	39	46	57	61	61	63	64	63	66	67	71
C2. Natural disaster	39	46	60	65	63	65	66	65	67	69	72
C3. Commodity price	39	47	54	62	68	71	72	72	76	78	82
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Figure 3. Madagascar Debt Dynamics - Baseline Scenario: Drivers of External Debt



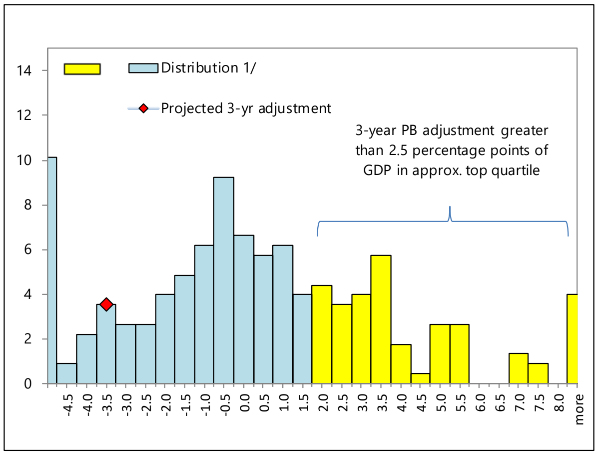
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

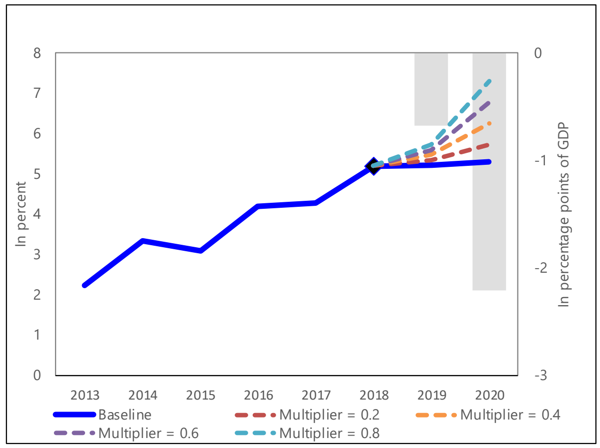
Figure 4. Madagascar: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



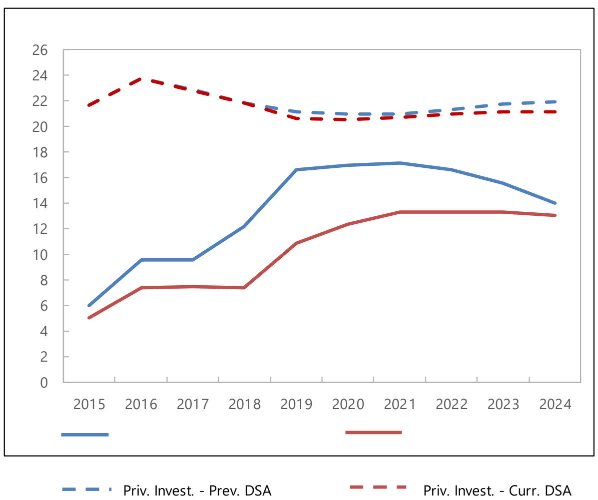
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/

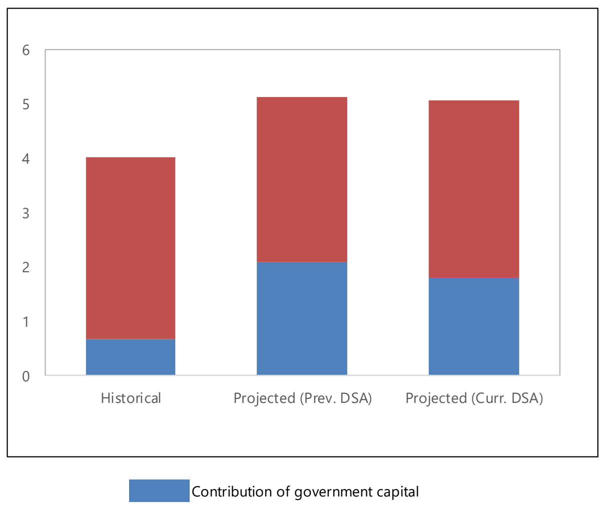


1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)



Statement by Mr. Raghani, Executive Director for Madagascar, Mr. Razafindramanana, Alternate Executive Director and Mr. Nguema-Affane, Senior Advisor to Executive Director
July 26, 2019

1. On behalf of the Malagasy authorities, we thank Executive Directors, Management and Staff for their continued policy advice and support in the context of the current Extended Credit Facility (ECF) arrangement. They appreciated the candid and constructive discussions with Staff in Antananarivo in June 2019 and believe that the staff report gives a good account of the progress made in the implementation of the ECF-supported program and the policies envisaged for the period ahead.

2. The outcome of the Parliamentary elections that took place in May 2019 gives a strong mandate to the authorities to carry out their ambitious economic reform agenda. The priorities of this agenda include strategies for (i) higher and sustained economic growth, based on the mobilization of tax revenues and the improvement in the quality of spending; (ii) more inclusion, supported by strengthened social policies and spending, with the objective of reducing poverty and increasing access to education, health, and housing; and (iii) better governance and institutions. Those priorities are consistent with the objectives of the ECF-supported program and will be formalized in the *Plan Emergence Madagascar* under preparation.

Program Performance

3. The implementation of the ECF-supported program in the period under review has been strong. All the end-December 2018 performance criteria (PCs) were met, some of them with margins. Two out of six indicative targets (IT) were not observed at end-December 2018. The IT on tax revenue was missed by the equivalent of 0.2 percent of GDP due notably to a strike in the tax administration. Priority social spending slightly fell short of its indicative target due to lower domestically-financed investment. All end-March 2019 ITs were met except the one on social spending. Preliminary data at end-May 2019 indicate that all PCs for end-June 2019, the last test date of the ECF arrangement, should be observed. The IT on social spending is expected to be missed due to the under-execution of public investment. The structural reform agenda monitored in the program is advancing albeit at slower pace than expected. Of the eight structural benchmarks (SBs) for the second half of 2018 and the first half of 2019, five SBs were fully achieved, and significant progress has been made on the other SBs including those on the banking law and the law on financial stability.

4. The authorities remain committed to the objectives of the program which will expire by end-2019. In light of the performance at end-December 2018 and their continued commitment to the program, the authorities request the completion of the fifth review under the ECF arrangement.

Recent Developments, Outlook and Risks

5. Macroeconomic performance in 2018 was sound. Economic growth increased to 5.2 percent in 2018 from 4.3 percent in 2017, supported notably by a recovery in agriculture production. Inflation continued to decline from 9.1 percent in 2017 to 6.1 percent in 2018 and remained under control in the first half of 2019. Fiscal balance has turned positive despite lower-than-programmed revenue and public debt is sustainable. The risk of external public debt distress is low and the risk of overall public debt distress is moderate according to the recent debt sustainability assessment. The current account balance shifted from a deficit of 0.5 percent of GDP in 2017 to a surplus of 1 percent of GDP in 2018 on the back of higher vanilla and mining export receipts. Monetary and exchange rate policies have been successful in managing liquidity and accumulating international reserves, which stand above 4 months of imports.

6. Economic prospects remain positive. Growth is projected at 5.2 percent in 2019 supported by an acceleration of public spending in the second half of the year, before inching up to at least 5.3 percent in 2020 driven notably by the envisaged scaling-up and improved quality of public investment. The authorities share staff's assessment of the downside risks, notably a slower-than-projected acceleration of public investment. Moreover, as a low-income fragile country, Madagascar faces persistent and significant challenges. In particular, the country remains highly vulnerable to external and internal shocks, including climate change and terms of trade shocks particularly from oil, metal and vanilla prices. Going forward, the authorities are committed to accelerate progress in strengthening macroeconomic stability, promoting inclusive and sustainable growth, and reducing poverty in the context of the *Plan Emergence Madagascar*. Continued financial and technical support from the IMF remains essential, including to help catalyze financial support from donors.

Creating More Fiscal Space to Continue Increasing the Quality of Spending

7. Fiscal performance continued to improve in the first half of 2019. Total revenue overperformed thanks to ongoing reforms in the revenue administrations, while expenditures, including social spending, remained limited during the administrative transition and the preparation of a revised budget law. In this context, the authorities took advantage of the good fiscal position to repay all statutory advances from the central bank, *Banky Foiben'i Madagasikara* (BFM), and to accumulate deposits at the BFM.

8. Going forward, fiscal policy will focus on further enhancing domestic revenue mobilization and reducing nonessential spending to create fiscal space for higher public investment and priority social spending. The revised budget law for 2019 adopted in May 2019 reflects those priorities and is consistent with the program objectives. The domestic primary balance is expected to amount to a deficit of less than 0.4 percent of GDP in 2019 and will be fully financed thanks to budget support committed by the World Bank and the African Development Bank.

9. Revenue collection is expected to increase, supported by ongoing improvements in tax administration, including better collection of the value-added tax (VAT) payments on public investment projects and enhanced collection of tax arrears. The authorities are determined to ensure that the new tax incentives for investment offered in the new laws on Special Economic Zones and industrial development are effective and cost-efficient to safeguard the authorities' core objective of boosting revenue collection. Moreover, the tax policy unit has already undertaken an impact analysis of tax expenditures for 2016 and 2017 and is completing the one for 2018. The unit is also finalizing an analysis of the tax potential in Madagascar.

10. On the expenditure side, the 2019 wage bill has been slightly lowered, reflecting the authorities' commitment to implement the wage adjustment in the second half of 2019, while spending on goods and services will also be reduced to accommodate higher public investment and priority spending, notably in social sectors. The scaling up in public investment will be consistent with the country's absorptive capacity. The authorities will continue to use primarily concessional borrowing to finance higher public investment to maintain debt sustainability.

11. Implementation of fiscal-related reforms is progressing well. The fuel pricing reform aiming to limit liabilities to oil distributors is advancing, with an agreement reached between the authorities and the distributors on a new fuel reference price structure in June 2019. Following this agreement, pump prices were lowered by about 4.5 percent on average and are now closer to reference prices, thereby reducing liabilities to oil distributors to a level consistent with the related program objective. The adoption of a fuel pricing mechanism is expected in September 2019. A communication campaign to explain to the population the changes in the price structure and the fuel pump price is ongoing. The agreement on fuel pricing is also benefitting the public utility enterprise JIRAMA which is striving to improve its financial situation by lowering its operational costs, including through a renegotiation of contracts with suppliers and actions to fight fraud, with the assistance of the World Bank. This will help the company to avoid increasing tariffs. In the same vein, JIRAMA has prepared contingency plans in case the cost-saving measures do not yield the expected gains.

12. The authorities will sustain the momentum of fiscal reforms. The investment management capacity will be further reinforced in line with the recommendations from various technical assistance (TA) missions. In particular, they will streamline the procedures to speed-up project management, while strengthening controls and inter-ministerial coordination on the selection of investment projects. The authorities remain committed to enhance public financial management in the context of the 2018-2026 Strategic Plan of Modernization of Public Financial Management. They will notably continue to minimize fiscal risks and expand the coverage of the budget, by better supervising and integrating autonomous entities, state-owned enterprises (SOEs), and public-private partnerships (PPPs).

Maintaining Stable Inflation and Building External Resilience

13. The authorities remain committed to keeping inflation in single digits, with a focus on managing fluctuations in bank liquidity. The BFM is strengthening its monetary policy framework with the view notably to improve the management of excess liquidity and continue to gradually move to interest rate targeting. In this regard, the BFM introduced in May 2019 an overnight rate, in addition to its key policy rate for one-year maturity transactions. In pursuit of its mission of safeguarding external stability, the BFM will continue building international reserves, in the context of a flexible exchange rate regime, to progressively increase import coverage to 6 months or more, consistent with the convergence criteria of the Southern African Development Community (SADC).

Building a Sound Financial Sector Supporting Growth

14. The authorities will continue to pursue a sound and inclusive financial sector. The banking sector remained solid in 2018 with notably the reduction in non-performing loans (NPLs) to their lowest level in almost a decade. The financial sector landscape in Madagascar is changing, with notably the expansion of electronic money services and microfinance activities that foster financial inclusion, which poses new challenges to financial stability. To address those challenges, the authorities have prepared and revised several important legislations, including the draft banking law, the draft law on financial stability and the draft law on foreign exchange market, which will be submitted to Parliament. To further develop the foreign exchange (FX) market, a plan to gradually phase out the requirement to surrender export proceeds, has been prepared and will be approved following the adoption of the law on the foreign exchange market, if conditions do not destabilize the FX market. Going forward, the priorities to reinforce financial stability will include implementing risk-based supervision (RBS), and containing systemic risks with notably the expected approval this year of the banking law, the law on financial stability, and updated various prudential directives, in line with international standards and the Financial System Stability Assessment (FSSA) recommendations. The modernization of the central bank operations will continue. BFM remains committed to fully adopt International Financial Reporting Standards (IFRS) for its 2020 accounts, with the IMF technical assistance. It will continue its efforts to strengthen internal and external audit mechanisms as per the safeguard assessment recommendations.

Enhancing Economic Governance and Improving the Business Environment

15. The governance and transparency frameworks are being reinforced. The law on anti-money laundering and combating the financing of terrorism (AML/CFT), which better aligns the AML/CFT framework with international standards, was enacted in February 2019. The related implementation decrees will be issued by end-September 2019. The asset recovery law, which enables seizure and confiscation of proceeds of crime, has been adopted in June 2019 and promulgated in July, thereby completing the legal anti-corruption framework. The

authorities are strengthening the institutions responsible for effective enforcement of this new legal framework, with the ongoing establishment and operationalization of a second anti-corruption court in Mahajanga. Transparency is increasing, as the reporting on various governance activities, including some court decisions and data on investigations on corruption, is expanding. The authorities are confident that these reforms will contribute to improving the business environment and stimulating private investment.

Conclusion

16. Madagascar is continuing to make good progress in strengthening macroeconomic stability, promoting inclusive and sustainable growth, and reducing poverty. Implementation of the authorities' program under the ECF has been strong during the period under review. Going forward, the authorities are determined to sustain the momentum of reforms, consistent with the objectives of the program in the context of the *Plan Emergence Madagascar*. In this light, our Malagasy authorities will appreciate Executive Directors' favorable consideration of their request for the completion of the fifth review under the ECF.