INTERNATIONAL MONETARY FUND

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MALAWI

December 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Malawi, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 13, 2021 consideration of the staff report that concluded the Article IV consultation with Malawi.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 13, 2021, following discussions that ended on November 4, 2021, with the officials of Malawi on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 30, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF and the World Bank.
- A **Statement by the Executive Director** for Malawi.

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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PRESS RELEASE

PR21/377

IMF Executive Board Concludes 2021 Article IV Consultation with the Republic of Malawi

FOR IMMEDIATE RELEASE

Washington, DC – December 13, 2021: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Malawi on December 13, 2021.

Malawi's economy has been severely affected by the COVID-19 pandemic and faces additional challenges. Growth has contracted by 4½ percent in 2020 compared to pre-pandemic levels in 2019, while the number of cumulative positive cases of COVID-19 has more than doubled in the first half of 2021. In recent months, there are signs of gradual recovery and daily COVID-19 positive cases remain relatively low. Helped by a good harvest, real GDP growth in 2021 is projected at 2.2 percent, up from 0.9 percent in 2020. Inflation is expected to increase to 9.0 percent in 2021 from 8.6 percent in 2020, driven by increases in prices for fuel, fertilizers, and food.

President Chakwera's *Malawi Vision 2063* aims for the country to reach upper-middle income status by 2063 by investing in physical and human capital. Under announced policies, which aim to implement a gradual pace of adjustment and maintain fiscal and current account deficits over the medium term to meet substantial development and social spending needs, the economy is projected by staff to recover gradually to reach 4.5 percent growth by 2023.

The outlook is predicated on the assumption of continued domestic and external financing. It assumes Malawi will be able to sustain higher public investment than experienced in the past decade, have strong fiscal multipliers, maintain fiscal and external deficits on the order of 10 percent of GDP over the medium term, and continue to access sizable financing from regional development banks and domestic borrowing to close an estimated financing gap of about 4-5 percent of GDP each year. The growing debt burden is, however, projected to crowd out private sector investment and hinder medium-term economic prospects. Moreover, in spite of emergency COVID-19 assistance in 2020 and SDR allocation in 2021, the Reserve Bank of Malawi (RBM)'s gross reserve assets are projected to decline to 1½ months of next year's imports by end-2021, leaving the economy vulnerable to shocks.

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

Uncertainty surrounding the outlook remains high, and risks are tilted to the downside. The main risk to the outlook is a sudden stop of available financing especially from regional development banks. If this risk materializes, it could lead to an abrupt real exchange rate adjustment, import compression, significant impacts on growth and financial stability, and an adverse effect on the most vulnerable.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted that Malawi's economy has been severely affected by the pandemic and commended the authorities for their efforts to support the economy. Despite signs of gradual recovery, downside risks to the outlook persist. Directors stressed the need for determined implementation of policy adjustments to address Malawi's macroeconomic imbalances, restore debt sustainability, rebuild external buffers, and reduce poverty and inequality to improve social outcomes.

Directors underscored that restoring debt sustainability requires both addressing the legacy debt burden and adopting a strong fiscal adjustment program. While expenditures on containment measures and vaccine administration remain important in the near term, redoubling efforts on domestic revenue mobilization, curtailing and prioritizing current spending, and public financial management reforms are critical. Directors expressed concerns over Malawi's high risk of overall and external public debt distress.

Directors noted that a tighter monetary policy stance would be needed if inflationary pressures materialize. In this regard, they encouraged careful monitoring of money growth and pressure on the exchange rate. Directors also underscored the importance of vigilant financial sector supervision, through close monitoring of potential risks to financial stability and the development of prudential policy tools.

Directors noted the substantially weaker external position relative to the level implied by economic fundamentals and desirable policies. They stressed that allowing for greater exchange rate flexibility through a careful approach, containing external imbalances, and rebuilding external buffers are critical to reducing Malawi's vulnerabilities to external shocks.

Directors noted potential noncomplying disbursements during the 2018

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

Extended Credit Facility arrangement with the IMF and the need for resolution of this case of potential misreporting ahead of a new program. They urged the authorities to deliver on their commitment to conduct a special audit of foreign exchange reserves and improve the frequency and quality of data reporting.

Directors called for further efforts to strengthen public sector governance and institutions to safeguard scarce resources, strengthen policy effectiveness, and improve transparency and data provision, including on commitments and payments of COVID-19 related spending. Enhancing a robust cash management and control system of the national budget and strengthening the Board's oversight of foreign exchange reserve management at the RBM are important.

Directors noted the catalytic role that an IMF arrangement could play to support the adjustment effort and mobilize donor financing. They emphasized that progress towards an arrangement would depend on strong commitment to an adjustment program, sizeable financing support from the international community and Regional Development Banks in the form of nondebt creating flows.

While Malawi remains current on its payments to the IMF, Directors concurred with the post-financing assessment (PFA) conclusion, including with respect to Malawi's capacity to repay the IMF.

It is expected that the next Article IV consultation with Malawi will be held on the standard 12-month cycle.

Table 1. Malawi: Selected Economic Indicators, 2020-26

	2020	2021			2022	2023	2024	2025	2026
	Prel.	RCF Pre-rebase	RCF Post-rebase	Proj.			Proj.		
National accounts and prices (percent change, unless otherwise indicated)									
Real GDP	0.9	2.2	2.2	2.2	3.5	4.5	4.0	4.0	4.1
Nominal GDP (billions of Kwacha)	8,815	6,933	9,976	9,712	11,114	12,661	14,158	15,663	17,287
GDP deflator	8.5	8.5	8.5	7.8	10.6	9.0	7.5	6.4	6.0
CPI (annual average)	8.6	9.5	9.5	9.0	11.7	9.8	8.4	7.2	6.8
Central government (percent of GDP on a fiscal year basis)[1, 2]									
Revenue	14.9	20.0	14.1	14.8	14.3	14.3	14.4	14.4	14.3
Tax and nontax revenue	13.4	17.4	12.3	13.1	13.1	13.2	13.4	13.5	13.7
Expenditure and net lending	21.5	33.0	23.1	22.2	24.7	23.8	23.8	24.1	24.7
Overall balance (excl. grants)	-8.1	-15.6	-10.8	-9.1	-11.6	-10.6	-10.4	-10.6	-11.1
Overall balance (incl. grants)	-6.6	-13.0	-8.9	-7.4	-10.4	-9.5	-9.3	-9.7	-10.4
Financing gap/residual gap	0.8	0.0	0.0	-0.1	0.8	5.7	6.3	7.5	6.8
Domestic primary balance[3]	-1.7	-4.4	-2.9	-2.5	-5.1	-3.0	-2.5	-2.2	-2.3
Money and credit (percent change)									
Broad money	17.2	10.9	10.9	10.2	14.4	13.9	11.8	10.6	10.6
Credit to the private sector	16.4	11.7	11.7	30.1	14.2	12.6	10.1	9.4	7.5
External sector (US$ millions, unless otherwise indicated)									
Exports (goods and services)	966	1,245	1,246	1,078	1,197	1,331	1,522	1,704	1,890
Imports (goods and services)	3,052	3,402	3,410	3,208	3,298	3,262	3,248	3,520	3,693
Gross official reserves	566	958	974	394	402	415	461	498	511
(months of imports)	2.1	3.3	3.4	1.4	1.5	1.5	1.6	1.6	1.6
Current account (% of GDP)	-13.6	-20.3	-14.1	-15.0	-14.3	-12.6	-10.8	-10.7	-10.4
Overall balance (% of GDP)	-3.2	-1.4	0.4	-3.2	-4.2	-3.1	-2.3	-2.4	-3.5
Financing gap (% of GDP)	…	…	…	1.8	4.6	3.5	2.9	3.1	4.1
Debt stock and service (percent of GDP, unless otherwise indicated)									
External public debt	32.9	34.4	24.1	31.9	34.7	36.3	37.6	39.5	41.5
Total public debt	54.8	78.2	54.2	59.0	64.3	68.9	74.4	80.4	85.7
Ext. debt serv. (% of exports)	7.2	8.8	8.8	47.2	44.1	40.8	35.7	28.1	33.3

Sources: Malawian authorities and IMF staff estimates and projections.

[1]The current financial year, 2021, runs from July 1, 2020 to June 30, 2021. FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year starting from FY2022/23.

[2]Please note that government fiscal statistics are reported following the Government Finance Statistics Manual (2014) starting 2020 projections and going forward.

[3]Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and nontax revenues.

INTERNATIONAL MONETARY FUND

MALAWI

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

November 30, 2021

KEY ISSUES

Context. Malawi, a fragile state with one of the highest incidences of poverty, food insecurity and frequent weather-related shocks, has been severely affected by the pandemic. There are signs of gradual recovery and daily COVID-19 positive cases remain relatively low: real GDP growth in 2021 is projected to pick up to 2.2 percent from 0.9 percent in 2020 helped by a good harvest. However, inflation is expected to increase to 9 percent in 2021 from 8.6 percent in 2020, driven by increases in prices of fuel, fertilizer and food, leaving real per capita growth in the negative region.

Substantial development and social spending needs, a high debt burden from the past, and much reduced budget support and other grants financing since 2013 are contributing to sustained fiscal and current account deficits in the near to medium term. The financing gap is estimated at about 4-5 percent of GDP each year, and the overall and external public debt are assessed to be unsustainable under current policies. The large financing needs over the coming years and low international reserves suggest high risk of future debt distress. The debt burden is projected to crowd out private sector investment and to hinder medium-term economic prospects. Moreover, in spite of emergency assistance in 2020 and SDR allocation in 2021, the Reserve Bank of Malawi (RBM)'s gross reserve assets are projected to reach 1½ month of next year's imports by end-2021, leaving this fragile state vulnerable to external shocks. Risks to the outlook are tilted to the downside. The main risk is a sudden stop of available financing especially from the regional development banks (RDBs), and if this risk materializes, it could lead to an abrupt real exchange rate adjustment, import compression, significant impacts on growth and financial stability, and an adverse effect on the most vulnerable.

Focus of the Article IV consultation. The authorities' current policies are focused on a gradual and backloaded pace of fiscal and external adjustment and heavy reliance on nonconcessional borrowing from RDBs to address the large financing needs. This policy mix further elevates risks to the outlook. Staff urged the authorities to take upfront policy adjustments to address Malawi's macroeconomic imbalances. Discussions centered on policies to support urgent needs to address the humanitarian situation, restore debt sustainability, and rebuild fiscal and external buffers.

Fiscal policy. It will be important to anchor Malawi's fiscal framework in a way that stabilizes debt as well as taking immediate and upfront actions to restore debt sustainability as external public debt at 33 percent of GDP, a third of which on nonconcessional terms, is not compatible for a fragile state with urgent humanitarian spending needs and infrastructure deficits. Efforts to strengthen domestic revenue mobilization, reprioritize expenditure, increase realism in budget forecasts, and improve public financial management will be important in this regard. Given pressing debt service needs, delaying adjustment will exacerbate pressures down the road. Moreover, sizable support from the international community, including the RDBs, in the form of nondebt creating flows (e.g., debt relief and budget support) are vital as the adjustment alone cannot restore debt sustainability.

Monetary policy. The Kwacha has appreciated substantially in real effective terms in recent years, owing to limited nominal exchange rate adjustment, contributing to high current account deficits and a loss of foreign exchange reserves. Greater exchange rate flexibility accompanied by a stronger monetary and fiscal policy stance would help address foreign exchange shortages and potential inflationary pressures. Developing a well-functioning and transparent foreign exchange interbank market, enhancing recording, monitoring, and reporting of reserve assets as well as liabilities, and formulating a foreign exchange reserve management strategy are also critical. Moreover, there are potential noncomplying disbursements under the 2018 Extended Credit Facility (ECF) due to the possible inclusion of encumbered assets that inflate reported reserves. The authorities have committed to undertake a special audit of foreign exchange reserves.

Governance. Strengthening public sector governance and institutions would help safeguard scarce resources, reduce vulnerabilities to corruption, and strengthen policy effectiveness. The mission urged publication of comprehensive fiscal reports to further enhance budget transparency and accountability. It is also important for the authorities to complete COVID-19 spending audit reports of two remaining tranches and take follow-up actions on the findings of the audit report completed by the National Audit Office (NAO) which identified irregularities and mismanagement in the procurement and contract awarded process of COVID-19 related public funds.

Approved By
Vivek Arora (AFR) and Björn Rother (SPR)

Virtual missions were held during July 20-27, 2021 and October 28-November 4, 2021. The staff team comprising Ms. Saito (head), Ms. Farid, Ms. Gwenhamo, Ms. Yoon, Ms. Shirakawa (all AFR), Ms. Hashimoto (SPR), Ms. Prihardini (FAD), Mr. Banda (local economist), and Mr. Anderson (FAD long-term expert) exchanged information and held discussions with the Hon. Felix Mlusu (Minister of Finance), Dr. Wilson Banda (Governor of the Reserve Bank of Malawi, RBM), other senior government and RBM officials, representatives from the banking sector, development partners, and civil society organizations. Ms. Nainda (OED) joined the discussions. Mr. Guzman and Mr. Ould Abdallah provided research support and Ms. Lertprasert assisted the team in the preparation of this report. The team thanks the authorities for their collaboration and fruitful discussions.

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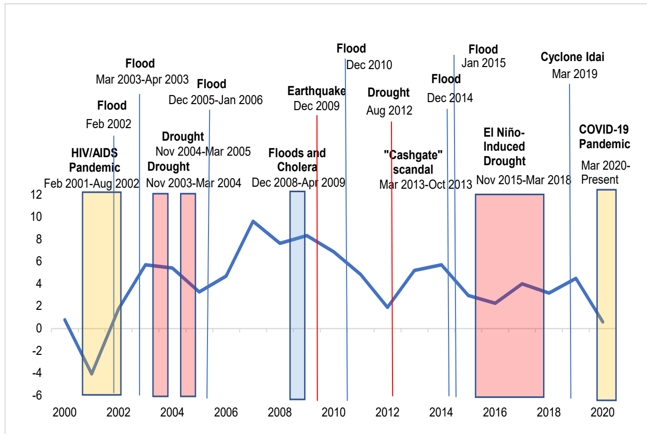
CONTEXT

1. **Malawi's new government since mid-2020 has signaled a break from policies of the past and a focus on inclusive and self-reliant growth**. President Lazarus Chakwera, leader of the Malawi Congress Party (MCP), won the presidential elections in June 2020. The new administration launched Malawi's long-term growth strategy "Malawi Vision 2063" that aims for Malawi to reach upper-middle income status by 2063. The vision is anchored on the Sustainable Development Goals and aims to address underlying causes behind the lack of sustained economic growth and heavy reliance on aid over decades. Growth is seen as having been overly reliant on foreign aid and vulnerable to weather-related shocks, which affect tobacco exports (Text Figure 1).

Text Figure 1. Malawi: Extreme Weather Events and Growth, 2000-20

Growth is highly vulnerable to extreme weather events including floods and droughts caused by deforestation.



Source: EM-DAT database; and IMF staff estimates.

2. **Sizeable macroeconomic imbalances and unsustainable debt are besetting the authorities' efforts and the outlook.** This dire macroeconomic situation is the outcome of the policy choices of distant- and recent-past:

- *Fiscal deficits have resulted in unsustainable debt* (Text Figure 2). Budget deficits have remained high, reflecting limited adjustment in spending and low domestic revenue mobilization. The deficit has been financed mainly by costly domestic borrowing, as external budget support and grants (that averaged 5.8 percent of GDP during 2005-13) has been much reduced (1.8 percent of GDP) since the 2013 "Cashgate".[1] Rising domestic financing (since 2018) as well as borrowing from regional development banks (RDBs) on a non-concessional basis has significantly increased Malawi's public debt, which stood at 55 percent of GDP in 2020 (of which 10 percent of GDP was non-concessional external debt).

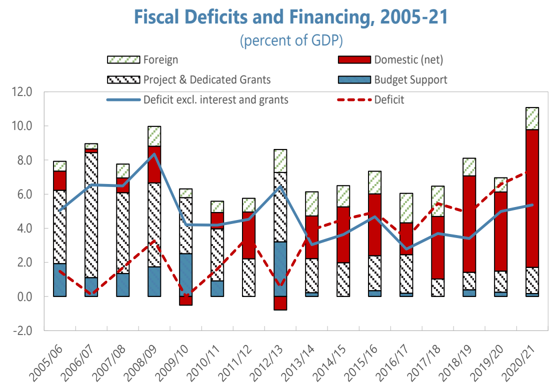
- *Current account deficits have contributed to dwindling gross international reserves.* The Reserve Bank of Malawi (RBM)'s foreign exchange intervention in recent years has sought to maintain a broadly stable nominal exchange rate with short-term currency swaps with RDBs. The current account deficits fluctuated around 12-15 percent of GDP since 2015 as imports remained strong while tobacco exports stagnated. Gross international reserves declined to $406 million (or about 1½ months of next year's imports) at end-October 2021.

[1] "Cashgate", a major corruption case that led to arrests, trials and convictions of a number of civil servants.

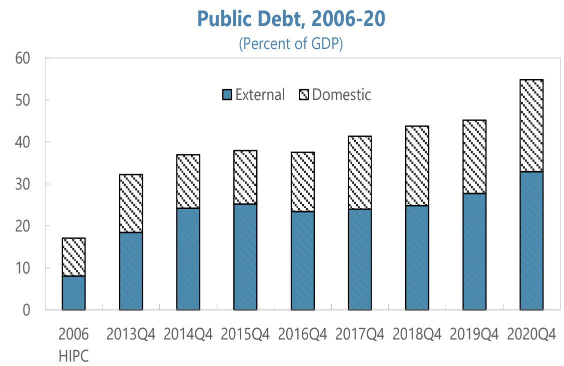
- *The COVID-19 shock has exacerbated macroeconomic imbalances.* The authorities responded with an easing of fiscal and monetary policy since March 2020 ([IMF COVID-19 Policy Tracker for Malawi](#)). A third round of COVID-19 infections hit the country in February 2021 before starting to decline mid-year (Text Figure 2). The government rolled out in February 2021 a National COVID-19 Vaccine Deployment Plan with a target of reaching 20 percent of the population (3.8 million) by end-2021, benefiting from the COVID-19 Vaccines Global Access (COVAX) Facility. In addition, 100,000 doses covering 0.5 percent of the population have been secured through the African Union. As of mid-October, 2.8 percent of the total population was fully vaccinated.

Text Figure 2. Malawi: Challenges Confronting a Fragile State, 2005-21

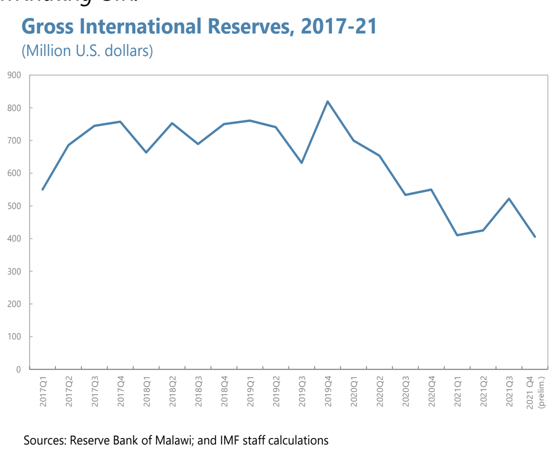
Budget support (blue) and grants have been replaced by domestic borrowing (red), hiking overall deficits….



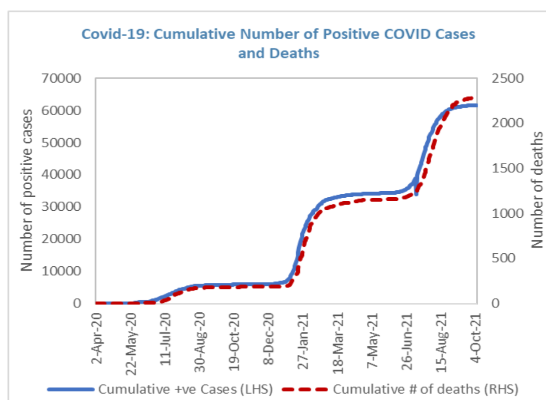
….and public debt rose from about 32 percent of GDP at end-2013 to 55 percent of GDP in end-2020.



External budget support and grants have been replaced by costly short-term currency swaps and trade credit, dwindling GIR.



The COVID-19 shock has added to the criticality of addressing macroeconomic imbalances.



Source: Malawian authorities; IMF staff estimates.

3. **The new administration is prioritizing improved governance and transparency and addressing gaps that led to the loss of budget support**. In July 2020, key officials were replaced after being implicated in the mismanagement of COVID-19 public funds, potential money

laundering, and other charges.[2] Actions are already being taken against civil servants involved in the mismanagement of COVID-19 funds. In addition, a Vice President's Taskforce has been formed mid-April to introduce structural changes to the civil service, including the system of allowances, employment contracts, and procurement in the public sector.

4. **The authorities have requested an arrangement under the Extended Credit Facility (ECF)**. Given the protracted balance of payments problem, Malawi is facing challenges in implementing economic programs envisaged in Malawi Vision 2063 without support from the IMF and the international community at large. While IMF support and its catalytic role in mobilizing donor support is critical at this juncture, being able to restore debt sustainability in the medium term is a pre-requisite for such support. In this context, a strong commitment for an adjustment program as well as sizeable support from the international community, including the RDBs, in the form of nondebt creating flows (e.g., debt relief and budget support) are vital as the adjustment alone cannot restore debt sustainability. Moreover, the authorities have committed to undertake a special audit of foreign exchange reserves in response to noncomplying disbursements ("misreporting") under the 2018 ECF arrangement. Resolving the misreporting case would be a pre-condition for a new Fund arrangement.

RECENT ECONOMIC DEVELOPMENTS

5. **Malawi's economy has been severely affected by the pandemic; and while daily COVID-19 positive cases remain relatively low, recovery is gradual.** The National Statistics Office (NSO) reports that real GDP growth declined from 5.4 percent in 2019 to 0.9 percent in 2020[3] (Figure 1; Annex VIII). While high frequency data on economic activity are limited, there are a few signs of recovery in 2021. The year-on-year increase in imports through September 2021 is 25 percent; domestic revenue through June is tracking the revenue-to-GDP ratio seen in previous years (Figure 2). Real GDP growth in 2021 is projected to pick up to 2.2 percent helped by a good harvest.

6. **Pressure on inflation is beginning to emerge following a monetary expansion and currency depreciation since mid-2020** as the RBM began to scale back FX intervention. The accommodative monetary policy stance, exchange rate pass-through, and increases in prices of fuel and fertilizer are contributing to a rise in non-food inflation from 4.9 percent at end-2020 to 7.2 percent at end-September 2021. Food inflation remains above 10 percent despite a good harvest, reflecting supply chain disruptions related to COVID-19. As a result, headline inflation has increased from 7.6 percent at end-2020 to 8.9 percent at end-September 2021 (Figure 1).

7. **Foreign exchange reserves have declined sharply as the RBM scaled back FX intervention**. The currency swaps with RDBs (¶12) were scaled back by the new RBM leadership since

[2] The officials included key personnel at the central bank, cabinet, and public procurement office.

[3] IMF Country Report No. 19/361 projected real GDP growth to decline by 3.9 percentage points from 4.5 percent in 2019 to 0.6 percent in 2020.

July 2020. GIR declined from US$766 million at end-June 2020 to US$406 million at end-October 2021 (Figure 1).[4]

8. **Malawi's external position in 2020 is assessed to be substantially weaker than the level implied by medium-term fundamentals and desired policies** (Annex I).[5] The current account deficit expanded from 12.6 percent of GDP in 2019 to 13.6 percent in 2020, resulting mostly from a significant decline in exports and an increase in pandemic-related imports. Malawi's GIR at 2 months of next year's imports are inadequate to absorb external shocks.[6]

OUTLOOK, SPILLOVERS, AND RISKS

9. **Economic growth is projected to recover to reach a small positive per capita growth but this outlook is predicated on the assumption that external financing from RDBs will continue**. Under announced policies which maintain the accommodative fiscal policy stance, the economy is projected by staff to recover gradually to reach 4.5 percent growth by 2023, a small positive per capita growth.[7] This outlook depends critically on: (i) a sustained increase in public investment relative to levels experienced in the past decade (see ¶58) with strong fiscal multipliers of public investment; (ii) the maintenance of a fiscal deficit on the order of 10 percent of GDP over the medium term (and external current account deficits of similar size); and (iii) continued access to sizable and further growing RDB financing as well as domestic borrowing to cover large financing gaps in spite of unsustainable debt (¶12). As a result, however, the debt burden will continue to grow, and the debt burden is projected to crowd out private sector investment and to hinder medium-term economic prospects. Continuing to depend on non-concessional loans from the RDBs, however, comes with risks (¶14) and at a cost (¶12).

10. **CPI inflation is projected at 10 percent at end-2021 and about 6.8 percent at the end of the medium term provided that the monetary policy stance is well anchored**. The projection captures anticipated depreciation of the currency and passthrough to inflation as the RBM winds down foreign exchange interventions and currency swap operations. The success of the RBM in managing inflationary pressures would hinge on its ability to sterilize the monetary impact of reduced forex sales and the government's commitment to contain fiscal deficits.

11. **Gross international reserves are projected to remain at about 1½ months of next year's imports with financial support from RDBs as in the recent past, leaving Malawi vulnerable to shocks**. With only a gradual and limited adjustment in the exchange rate and limited fiscal adjustment envisaged, current account deficits are projected to remain elevated. As a result,

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[4] GIR figures reported in this staff report include encumbered deposits, which will be excluded once an audited numbers become available.

[5] The 2020 External Sector Assessment adjusts for the impact of COVID-19 pandemic and natural disasters.

[6] The adequate level is estimated at 3.9 months of next year's imports according to the staff's reserve adequacy model for credit constrained economies.

[7] The pandemic-specific factors are incorporated in addition to the standard fiscal multiplier (0.6) for 2022-23.

the pressure on reserves will continue and the RBM's reserve liabilities (in the form of currency swaps and trade credit) are projected to increase during the medium term. Limited buffers would be available to absorb external shocks such as adverse climate events. The external financing needed (shown as a financing gap in Box 1) is estimated at about 4-5 percent of GDP each year in the medium term.

12. **Malawi's overall and external public debts are assessed to be in high risk of debt distress; and both external and public debt are assessed as unsustainable under current policies**. Malawi's external debt distress rating, based on the DSA, has changed from "moderate risk of debt distress" (October 2020 DSA) to "high risk of debt distress; and granularity in risk rating assess that external and public debt are unsustainable under current policies." There are sustained threshold breaches on a number of debt stock and debt service indicators, including an existence of external arrears at the end of 2020 which have been rescheduled in 2021.[8] The debt service burden is exacerbated by: (i) a change in debt carrying capacity from medium to low; (ii) moving the DSA from a currency to a residency basis in order to accurately classify and capture medium-term domestic bonds held by nonresidents as external debt; and (iii) the conversion of the RBM's short-term reserve liabilities to medium-term external debt. Under the baseline scenario, public debt would increase further from 54.8 percent of GDP in 2020 to 85.7 percent of GDP in 2026 as the authorities rollover existing domestic and external debt. Covering these large financing needs would be achieved through: (i) disbursement of ratified but undisbursed concessional loans during the medium term; (ii) additional nonconcessional external borrowing (in the form of nonresident participation in the domestic debt market) as in the past; and (iii) net domestic financing for the remaining financing gap. The large financing needs over the coming years and low lovel of international reserves suggest high risk of future debt distress.

13. **Inward spillovers of easy liquidity conditions in advanced economies are channeled through regional development banks**. Malawi does not have access to international markets but has access to nonconcessional external financing through RDBs for several years. The RDB financing has been supported in recent years through ample liquidity on global markets, which made the interest spread attractive for on-lending operations to countries without access to international markets. Some of these banks have expanded debt security issuance and loan book by more than 10 times over the past 10 years.

14. **Risks to the outlook are tilted to the downside**.

- A risk associated with growing RDB financing followed by a sudden stop is a high-probability and high-impact risk if the risk materializes. The attractiveness of on-lending operations by RDBs could be affected by a normalization of monetary policy in advanced economies. This effect could exacerbate a further worsening of Malawi's outlook. A sudden stop could lead to an

[8] Malawi had external arrears outstanding to Spain and the Trade Development Bank (TDB) as of end 2020. The authorities have been engaged in good faith negotiation in 2021 with both creditors and repayments have started payments an agreed schedule: (i) repayments to Spain started in May 2021 and will continue to November 2023; and (ii) the authorities met their debt obligations to TBD up to April 2022.

abrupt real exchange rate adjustment, import compression, significant impacts on growth and financial stability (with abrupt changes in consumption and investment behavior of both the public and the private sectors), and an adverse effect on the most vulnerable.

- Other risks include uncertainty to the recovery due to risks of another COVID-19 wave and weather-related events. Domestic risks include governance issues affecting the efficient use of public resources and delays in PFM reforms and domestic revenue mobilization that in turn can lead to a further widening of macroeconomic imbalances. Additional risks include fiscal dominance in the conduct of monetary policy and accumulation of additional external non-concessional borrowing. If such risks materialize, an abrupt adjustment may be inevitable.

- On the upside, faster recovery supported by the mining sector, successful resolution of unsustainable debt service, and strong reforms program implementation could boost confidence and pave the way for a resumption of budget support from development partners (Risk Assessment Matrix in Annex II).

Authorities' Views

15. **The authorities project a higher and near-term impact of domestically financed capital spending on growth compared to staff's projection**. They are exploring possible investment and growth potential in the mining sector that could result in positive growth spillovers and higher export receipts. The authorities plan to implement revenue measures as well as manage expenditures and focus on export diversification to reduce both fiscal and current account deficits.

16. **In the authorities' assessment, the fiduciary environment around the recently issued Local Currency Infrastructure Bond is very good and funds are ringfenced that the risk of funds being misused is very minimal**. On this basis, the authorities see that the more appropriate overall characterization of the governance risk to be medium. Both local and foreign financed projects have the best governance structures, which include Project Steering Committees, Technical Committees and mandatory external annual audit.

17. **The authorities are undertaking policy actions to address debt sustainability through engagement with creditors, including the RDBs**. The authorities are also engaging with RDBs and other donors for possible voluntary debt buy back schemes to offset more expensive debt.

POLICIES FOR ECONOMIC STABILITY AND GROWTH

As a fragile state, Malawi needs donor budget support as borrowing on nonconcessional terms to meet the basic spending needs of a rapidly expanding population is not sustainable. Given macroeconomic imbalances, the fiscal and external policy effort should be anchored around debt-stabilizing primary fiscal and current account balances guided by the DSA; combined with the authorities' immediate and upfront actions to restore debt sustainability.

A. Fiscal Policy: Enhancing Fiscal Discipline

Background

18. **Expenditure overruns due to weak commitment controls, revenue shortfalls due to optimistic budget projections, and rising domestic borrowing have characterized the fiscal landscape of the past several years**. With the withdrawal of external budget support and grants financing since 2013, the domestic primary deficit remained at around 1 percent for several years. However, costly domestic borrowing resulted in a rapid increase in interest payments, widening the overall deficit (Text Figure 2).

19. **More recently, expenditure has expanded substantially partly due to elections and the pandemic, while domestic revenue mobilization efforts showed little results**.

- Expenditure has expanded from 19.6 percent of GDP in 2018/19 to an estimated 22.2 percent of GDP in 2020/21. This reflects spending on COVID-19 containment, one-off expenditures (e.g., for the 2019-2020 elections) and policy measures. A civil service wage increase in October 2020 contributed to a rise in the wage bill. An expansion of the fertilizer and seed subsidy (Affordable Input Program, AIP) from just under 1 million beneficiaries to 3.8 million beneficiaries increased the cost from 0.5 percent of GDP to 1.5 percent of GDP. The buildup of debt has seen interest payments jump from 2.9 to 3.8 percent of GDP in 2018/19 and 2020/21, respectively.

- The authorities have prepared the Domestic Revenue Mobilization Strategy (DRMS) with support from the IMF and other development partners. The DRMS is focused on improvements in tax administration and policy reform to expand the tax base. The authorities have begun to implement some of the measures identified in the DRMS, such as introducing an import withholding tax in the FY 2021/22 Budget. At the same time, they have increased the tax-free threshold in the Personal Income Tax (PIT), reducing the tax base.

20. **The overall deficit for FY2020/21 is estimated at 7.5 percent of GDP, well above the 5.8 percent of GDP seen in FY2019/20** (Figure 2). Compared to the projection in the October 2020 Staff Report (IMF Country Report No. 20/288), tax revenue outperformed in FY2020/21. The Expenditure outturn was slightly above its projected level, driven by higher interest rate payments and spending on goods and services, but partly offset by delays in executing capital spending.

21. **The government plans to maintain the current fiscal policy stance through the medium term**. It sees a strong focus on capital expenditure going forward as being an important foundation for long-term inclusive growth. Efforts to improve revenue administration are ongoing, supported by capacity development from the IMF and other development partners. The authorities are reviewing the VAT Act, including rationalizing the list of exempt and zero-rated items, which could lead to additional revenue.

22. **The authorities announced arrears clearance measures in September 2021**. Domestic arrears mainly reflect unpaid bills from 2012 and 2013. Approximately MWK 158.9 billion (1.7

percent of GDP) in arrears have been audited and verified, reflecting commitments made up to June 2020. The clearance strategy consists of issuing zero-coupon promissory notes (MWK 145 billion, of which MWK 110 million has been issued as of August 2021), cash payments for small amounts outstanding (MWK 5 billion), and tax refunds (MWK 9 billion). These new measures follow an earlier arrears clearance effort which ended in FY2018/19.

Policy Advice

23. **Restoring debt sustainability would require both addressing the legacy unsustainable debt burden and a forward-looking anchoring of Malawi's fiscal program** at a minimum reaching a debt stabilizing primary balance so that it can return to a moderate risk of debt distress within the medium term. Both public and external debt are assessed as unsustainable. In the near term, priority must be given to expenditure on COVID-19 containment measures, the administration of vaccines, and the completion of capital expenditure projects started in FY2021/22. Over the medium term, a strong fiscal effort is necessary to reduce the primary deficit, projected at about 4.3 percent for FY2021/22, to a balanced position[9] not later than 2026. The pace of adjustment is equivalent to at least 1 percentage point of GDP adjustment during FY2022/23-FY2025/26. As shown in the reform scenario (Box I), with this pace of adjustment, total public debt will continue to rise over the medium term and debt sustainability will not be restored. This pace of adjustment, however, can help reduce the risk of debt distress to "moderate" in the medium term, if supported by strong reforms, and nondebt creating flows (e.g., debt relief and budget support grants from creditors and development partners). Delays or a lack of support would make the size of adjustment larger and sharper.[10] Realism in budget forecasts and public financial management (PFM) reforms would help contain fiscal deficits and debt (¶25).

24. **DRMS needs prioritization**. Ministerial-level guidance is needed to determine policy priorities and speed of implementation. Staff underscored the importance of implementing the DRMS with an aim to raise at least an additional 2 percent of GDP (cumulative) of revenue from tax policy measures such as broadening the base of the value added tax (VAT) and corporate income tax (CIT), reforming excise and carbon taxes, and further reforming the PIT. In addition, tax administration measures should raise, as a minimum, an additional 0.5 percent of GDP (cumulative) over the medium term (see Text Table 1, based on DRM TA provided in May 2020).

25. **Reprioritizing expenditure would provide fiscal space to expand macro-critical capital outlays.** It is critical for the authorities to rationalize expenditure through curtailing growth in wages; reform the AIP and goods and services spending; and reduce non-critical spending[11]. This is

[9] The debt-stabilizing primary balance in 2026 under the reform scenario is 0 percent of GDP.

[10] The debt-stabilizing primary balance in 2026 under the baseline scenario is 1½ percent of GDP. The primary deficit is projected at 5½ percent of GDP in 2025/26, which makes the size of adjustment needed to restore debt sustainability at 7 percentage points of GDP.

[11] Under the baseline, the AIP remains broadly unchanged between FY2021/22 and FY2022/23 in level terms. However, the annualization to account for a 9-month fiscal year for FY2021/22 inflates the size of the AIP and other agriculture-related payments as a percent of GDP, since these payments are concentrated in one quarter.

expected to free 2 percent of GDP in fiscal space (Text table 1), part of which will be redirected to development expenditure and is in line with Vision 2063 and the post-pandemic recovery plan.

26. **Improvements in commitment controls are critical in preventing further accumulation of arrears, containing the size of public debt, and strengthening fiscal governance.** The pace of implementation of the new Integrated Financial Management and Information System (IFMIS) has accelerated and the new system will help with (i) expenditure control, particularly for managing multi-year commitments (a major source of arrears) and (ii) timely reconciliation of data (revenue, expenditure and financing) across institutions. The latter would also help enhance debt data management.[12] In the interim, changes in business processes and culture can be instigated to prevent the creation of new arrears. This will require high-level political commitment, large-scale communication efforts and ensuring the right incentives for government ministries, departments, and agencies (MDAs). Staff stressed the importance of completing implementation of the IFMIS, the passage of the Public Financial Management (PFM) Act, and publication of a comprehensive monthly fiscal report building on the existing quarterly budget performance reports. If arrears continue to accumulate, a more strategic clearance strategy is needed (prioritization, negotiation with creditors) rather than relying on promissory notes alone.

Text Table 1. Fiscal Policy Measures, change relative to FY 2020/21
(in percent of GDP)

	2021/22	2022/23	2023/24	2024/25
Domestic Revenue	0.7	1.1	1.6	2.2
Policy measures	0.3	0.7	1.3	2.0
Import withholding tax	0.1	0.1	0.1	0.1
VAT base broadening	0.1	0.3	0.6	1.0
CIT base broadening	0.0	0.1	0.1	0.2
Excise and Carbon Tax	0.0	0.1	0.3	0.5
User fees and charges	0.0	0.1	0.2	0.2
Tax administration measures	0.0	0.1	0.3	0.5
Expenditure (excl. interest and foreign-financed development spending)	0.2	(1.1)	(1.3)	(1.6)
Expenditure measures	(0.0)	(1.4)	(1.8)	(2.1)
Wage bill	(0.2)	(0.5)	(0.7)	(1.0)
AIP	0.5	(0.2)	(0.3)	(0.5)
General goods and services	(0.3)	(0.7)	(0.7)	(0.7)
Overall Balance	(0.5)	0.0	0.3	1.0
Domestic Primary balance	0.5	2.2	2.9	3.8

Source: Staff estimates.

27. **The authorities need to work with development partners to ensure that social spending continues to support the vulnerable, particularly if risks materialize**. The bulk of social spending to protect the vulnerable (health and social cash transfers) are off budget and funded by development partners. The size of the transfer should be reviewed and adjusted for inflation so that it continues to cover basic consumption needs of the most vulnerable households.

[12] The latest Debt Management Performance Assessment (DeMPA) by the World Bank was conducted in 2019.

Box 1. Malawi: Reform Scenario, 2021-25

The reform scenario aims to stabilize the public debt so that Malawi can return to moderate risk of debt distress within the medium term. Accordingly, the size of fiscal adjustments is set at about 1 percentage point of GDP each year, which is consistent with policy adjustments identified in recent technical assistance reports (Text Table 1). The scenario envisages rebuilding gross official reserves to return to an adequate level over the medium term. The corresponding size of external sector adjustment is 1½ percent of GDP each year. This would be supported by greater exchange rate flexibility and stronger monetary and fiscal policy. The reform scenario still has a financing gap of about US$1.6 billion or about 4 percent of GDP each year in the medium term. If the gap is financed by nonconcessional borrowing, the risk of debt distress will remain high. Moreover, if the financing gap were not filled, it could lead to an abrupt adjustment with significant impacts on growth and financial stability, and an adverse effect on the most vulnerable. But if it is filled by nondebt creating flows (e.g., debt relief and budget support grants), Malawi can return to a moderate risk of debt distress. Any reform delays would make the size of adjustment larger and more abrupt.

Box Table 1. Malawi Baseline versus Reform Scenario: Selected Economic Indicators, 2021–25

	Baseline[1] (Discussed during the Article IV mission-October 2021)						Reform (Discussed during July 2021 mission)					
	2021	**2022**	**2023**	**2024**	**2025**	Cummulative change 2021-25	**2021**	**2022**	**2023**	**2024**	**2025**	Cummulative change 2021-25
National accounts and prices (percent change)												
Growth	2.2	3.5	4.5	4.0	4.0		2.2	3.0	4.5	5.0	6.0	
GDP deflator	7.8	10.6	9.0	7.5	6.4		8.5	8.1	6.4	5.1	4.4	
Central Government (percent of GDP)												
Revenue	14.8	14.3	14.3	14.4	14.4	-0.4	14.4	14.5	14.9	15.3	15.8	1.4
Expenditure	22.2	24.7	23.8	23.8	24.1	1.9	22.7	23.3	23.1	23.3	23.0	0.3
o/w interest	3.8	3.8	4.7	5.2	5.7		3.7	3.8	4.8	5.3	5.6	
Overall	-7.5	-10.4	-9.5	-9.3	-9.7	-2.2	-8.6	-8.8	-8.1	-7.9	-7.2	1.4
Domestic primary balance	-2.5	-5.1	-3.0	-2.5	-2.2	0.3	-3.4	-2.8	-1.1	-0.5	0.4	3.8
Financing	9.4	10.3	9.5	9.3	9.7		8.6	8.8	8.1	7.9	7.2	
o/w Financing gap	0.8	2.5	3.7	5.8	7.2	20.1		1.0	2.4	4.4	4.7	12.4
External Sector (percent of GDP)												
Current account	-15.0	-14.3	-12.6	-10.8	-10.7	4.3	-14.7	-14.0	-12.0	-10.7	-8.8	5.9
Capital and financial account	11.8	10.0	9.5	8.5	8.3		13.8	9.3	9.6	9.5	9.8	
Overall	-3.2	-4.2	-3.1	-2.3	-2.4		-0.9	-4.7	-2.4	-1.2	1.0	
Financing	3.2	4.2	3.1	2.3	2.4		0.9	4.7	2.4	1.2	-1.0	
o/w Financing gap	1.8	4.6	3.5	2.9	3.1	15.8	0.2	5.1	5.0	2.7	0.5	16.1
Memo: (percent of GDP; unless otherwise indicated)												
REER	1.0	3.1	2.9	3.0	2.6	14.2	2.1	7.9	5.5	5.6	4.6	25.7
GIR	394	402	415	461	498		464	468	747	890	1,027	
GIR in months of imports	1.4	1.5	1.5	1.6	1.6		1.8	1.8	2.8	3.3	3.7	
Public debt to GDP	59.0	64.3	68.9	74.4	80.4		59.3	65.4	69.6	73.0	75.0	

Sources: Malawian authorities; and IMF staff estimates.

1/ The baseline assumes that the external financing gap would be closed by additional borrowing from RDBs, with the stock of debt increasing from US$0.9 billion in 2020 to US$3.5 billion by 2025. Residual fiscal financing gaps would be covered by domestic borrowing.

Authorities' Views

28. **The authorities understand the need for fiscal adjustment and continue to work on reforms to narrow the deficit**. Discussions with the WB on better targeting of the AIP are ongoing. The review of the VAT Act has already resulted in the removal of banking fees and charges from the list of VAT exempt items. User fees and charges are also under review, and authorities recently announced the introduction of toll fees to fund road maintenance. The new PFM Act will include the

creation of a Debt Retirement Fund, which will be used to retire short term debt and free fiscal space. New revenue measures for this fund are under development.

29. **The authorities agree on the criticality of reducing the risk of debt distress back to moderate**. But they make a distinction between borrowing to support current expenditure versus borrowing to finance infrastructure investment. In their view, additional debt incurred to finance infrastructure and social safety net projects is vital to generate growth and to exit fragility even if the debt is non-concessional. They ringfenced a share of new debt issuance for key infrastructure projects. The stimulus from the construction phase of these projects is also important for supporting employment and incomes in the aftermath of the pandemic.

30. **The authorities are more optimistic than staff on the projected revenue path**. Tax administration initiatives, such continued efforts in improving compliance are expected to reap significant gains in revenue. The authorities are undertaking tax incentives review. Renewed interest in mining sector investment and reforms in the gold market will also contribute to revenue in the medium term. The rise in revenue will reduce pressure for expenditure rationalization. The authorities are of the view that the bulk of expenditure (wages, pensions, interest payments) are rigid, with little room for retrenchment.

31. **The authorities are confident with their PFM reforms**. They note that the new IFMIS, successfully rolled out to all MDAs in July 2021, and the new PFM Act will enhance commitment control, fiscal reporting and help address longstanding governance challenges.

32. **The authorities agreed that the main risk under both the baseline and reform scenarios is a sudden stop of available financing especially from the regional development banks**. If this risk materialized, an abrupt forced adjustment with a significant impact on growth, financial stability, and the most vulnerable population becomes inevitable.

B. Maintaining Price Stability and Financial Soundness

Background

33. **The monetary policy stance has been accommodative in 2020**. To mitigate the adverse impact of COVID-19, the RBM reduced the policy rate to 12 percent (by 150 basis points) in November 2020 and has kept it steady since then. Moreover, it has not been fully sterilizing the monetary impact of the decline in foreign exchange intervention, which resulted in reserve money (and broad money) year-on-year growth rising 33 percent and 25 percent, respectively, in September 2021.

34. **An Emergency Liquidity Assistance (ELA) framework was introduced to support banks in the event of worsening liquidity conditions**. The framework has been used for one commercial bank in April 2021. A debt moratorium and restructuring of loans to SMEs remains in place, to be approved on a case-by-case basis. The share of nonperforming loans (NPLs) in total loans has

stabilized to 6.4 percent at end-July from around 8 percent in preceding months. Based on available data, the banking sector remains well capitalized, liquid and profitable (Table 5).[13]

Policy Advice

35. **The monetary framework needs to remain anchored on containing reserve money growth in order to stabilize inflation pressures**. Staff emphasized that the RBM should allow for greater flexibility in the exchange rate (¶40) while maintaining price stability as its primary objective. In this regard, the RBM could use various instruments to drain excess liquidity from the system, including deposit auctions, sales of its holdings of government securities, and issuance of its own securities.

36. **The authorities should remain vigilant on financial sector supervision**. The RBM's and commercial banks' exposures to government securities need to be closely monitored. In addition, loan and collateral quality needs to be reassessed to promote financial sector stability. Given high credit growth, staff emphasized the need for improved credit risk management and developing micro and macro prudential policy tools.

Authorities' Views

37. **The authorities agree that monetary policy needs to be stronger to counteract inflationary pressure expected from greater flexibility in the exchange rate**. However, the RBM has expressed concerns from the impact of stronger monetary policy stance on increasing the cost of borrowing for the government and private sector investments.

38. **The authorities agree on the need for improved financial sector supervision and are seeking relevant technical assistance from the Fund**.

C. Rebuilding External Buffers

Background

39. **The trade deficit widened further in 2020**.

- Tobacco exports have been on a declining trend since 2014 (Text Figure 3). In 2020, however, in addition to a temporary U.S. suspension of imports of Malawi's tobacco, the COVID-19 pandemic also lowered tobacco and other exports.

- Imports continued to increase even during the period when fuel prices were declining. An increase in imports in 2020 partially reflect COVID-19 related imports and imports of fertilizers in support of the AIP.

[13] Data may need revisions once COVID-19-related forbearance data become available.

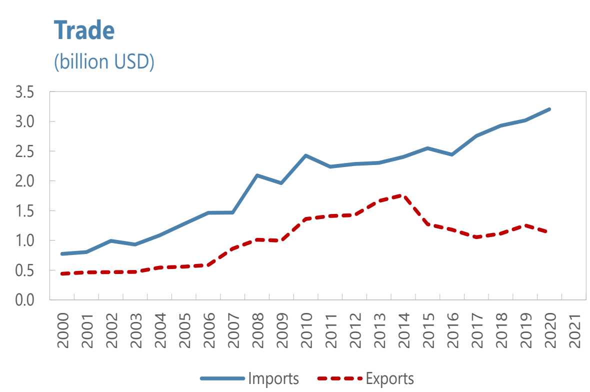
40. **The REER appreciated by over 30 percent since 2016 partly due to limited movement in the nominal exchange rate**. The current account deficit increased from 6 percent in 2014 to 13.6 percent of GDP in 2020 and the RBM's gross reserve assets declined to below adequate levels (¶8).

41. **In August 2021, the RBM re-introduced a surrender requirement on export proceeds to manage the shortages of foreign exchange on a temporary basis.**[14] The 30 percent surrender requirement on export proceeds seeks to induce exporters to step up foreign exchange supply to the interbank market while the RBM winds down its role as the supplier of foreign exchange.

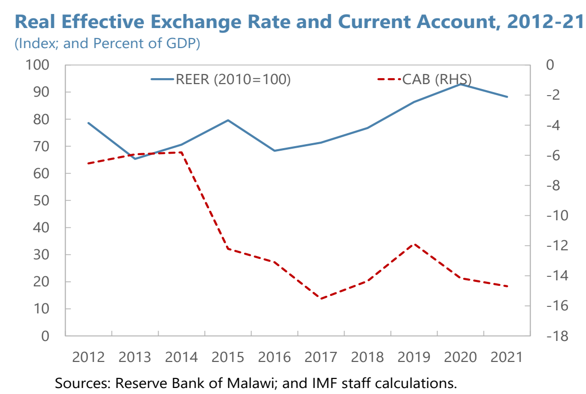
42. **The Special Drawing Rights (SDR) allocation, approved in August 2021, provided liquidity support to Malawi**. For Malawi, the SDR allocation is equivalent to about US$190 million or about 1.6 percent of GDP and it was transferred to the Government of Malawi. The authorities intend to use the SDR allocation to substitute the financing mix by reducing further accumulation of costly domestic borrowing, while maintaining the same budget envelope for FY2021/22. Through an arrangement between the RBM and Ministry of Finance governing the use of the SDR allocation, the government sold the SDR allocation to the RBM in exchange for Malawian Kwacha so that the RBM could meet short-term foreign exchange reserve liabilities due.

Text Figure 3. Malawi: REER and Current Account Balance, 2012-21

Imports continued to rise while exports stagnated since 2014 with a decline in the world demand for tobacco.



The REER has begun to adjust in 2020, but the current account deficits continued to widen.



Source: Malawian authorities; and IMF staff estimates.

Policy Advice

43. **Allowing for greater flexibility in the exchange rate, containing external imbalances, and rebuilding reserves are critical in reducing Malawi's vulnerabilities to external shocks**. Several elements need to come together to achieve this goal.

[14] The measure is being assessed by Staff as to whether it constitutes a capital flow management measure (CFM) according to the Fund's the Institutional View and a multiple currency practice (MCP) under Article VIII.

- Given the chronic shortages of foreign exchange and low reserves, and to support the start of the adjustment, a rapid adjustment towards a *market-clearing exchange rate* is necessary. With the anticipation of an adjustment at a future time, hoarding of foreign exchange by market participants may be exacerbating shortages.

- It is important to support this adjustment with a *tight monetary policy stance*. An adjustment towards a market-clearing rate may be accompanied by a temporary spike in prices. It does not, however, have to be followed by a prolonged period of Kwacha deprecation and inflation as in the case of 2012-16 episode, if the RBM is committed to contain reserve money growth (Text Table 2).

Text Table 2. Malawi: High vs. Low Inflation Episodes, 2012-21 (percent)

	2012M1-2016M2	2016M3-2021M6
Broad money	26	16
Base money	30	11
CPI	24	12
RBM exchange rate	39	8
Bureaux exchange rate	20	9

Sources: RBM; IMF staff calculations.

- It is important to support this adjustment with a *credible fiscal adjustment program* (¶19). In the 2012 episode, the fiscal policy stance was not compatible with the tight monetary policy stance. The deficit from 2012/13 to 2015/16 averaged 7 percent of GDP; and in 2012/13 the deficit widened by 2 percent of GDP (from 5.8 to 7.8 percent). Thus, there was continued pressure on the exchange rate, and hence inflation.

- Given the misalignment in the real exchange rate and unsustainable level of current account deficits, over the medium term, a sufficient adjustment of the REER, in the range of 30 percent, is necessary to improve the competitiveness of Malawi's exports, contain growth in imports, and bring the current account deficit back to more sustainable levels.[15]

- Given that Malawi has large energy-related imports, the authorities also need to carefully calibrate the pace, cost, and effects of their energy strategy. Malawi needs to include cost-effective investment in alternative energy sources away from firewood and charcoal— which aggravates deforestation, land degradation, and vulnerability to floods, landslides and food insecurity— and move towards sustainable power generation mix, guided by Malawi Renewable Energy Strategy (2017). In transition, these energy-related policy choices may put pressure on the foreign exchange market.

- The RBM's communications should be transparent and timely because clear communication enhances the effectiveness of monetary and exchange rate policies.

44. **Developing the foreign exchange interbank market is important**. The newly introduced surrender requirement on export proceeds should be used only on a temporary basis. Instead, it is important to develop a well-functioning foreign exchange interbank market that allows for transparent currency exchange and facilitates price discovery.

[15] The non-interest current account deficit that stabilizes debt in 2026 under the reform scenario is 7 percent of GDP.

45. **The RBM needs to formulate its reserve management strategy and address issues with its reserve assets and liabilities data promptly**. The strategy needs to clarify how the RBM will manage risks associated with reserve assets as well as reserve liabilities going forward. The strategy also needs to clarify how the RBM plans to enhance recording, monitoring, and reporting of reserve assets as well as liabilities. The RBM's inability to reverse its short-term currency swaps or to stay within a cap of a revolving trade credit facility should not be repeated. Issues with the reserves data, especially the possible inclusion of encumbered assets that inflate reported reserves, need to be addressed promptly. Moreover, the governance structure under which risks are assessed and managed should be guided by recommendations of the recent safeguards assessment report. The RBM should strive to improve data quality and reporting frequency and timeliness.

Authorities' Views

46. **The authorities are of the view that a gradual exchange rate adjustment is the preferred policy option**. The authorities believe that allowing for greater flexibility in the exchange rate will result in a spike in inflation as was observed in the 2012 episode and related concerns over fear of exchange rate passthrough on inflation. The RBM will remain vigilant to inflationary pressures and stand ready to tighten monetary policy as needed. In the meantime, the RBM is addressing obstacles to FX market development to deepen the foreign exchange market and pave the way for market-determined exchange rate by eliminating the daily 5 Kwacha band or the so called 'reasonable difference' among bids submitted by banks imposed by *Guidelines for Foreign Exchange Trading Activities*.

47. **The authorities agree that rebuilding reserves is a top priority and plan to adopt a reserve management strategy with a view to rebuild reserves going forward**. However, switching from being a net seller of forex to a net purchaser of forex in the short to medium term is seen as unattainable given tight liquidity conditions. The authorities are working on expanding the export base to include mining and non-traditional agricultural exports like legumes, maize, and industrial cannabis which will increase exports proceeds.

48. **The authorities' efforts to develop the foreign exchange market include issuing guidelines that require authorized dealer banks to sell 30 percent of all their purchases on the interbank market to prop up activity.** [16] Currently the foreign exchange market is concentrated on retail trading with very limited interbank activity.

D. Tackling Governance Challenges

Background

49. **Weaknesses in governance are long-standing issues in Malawi, and the current administration is taking action in this area but more efforts are needed**. The current

[16] The measure is being assessed by Staff as to whether it constitutes a CFM according to the Fund's the Institutional View.

administration has followed up the report on mismanagement of COVID-19 funds and has taken administrative actions against the civil servants allegedly involved. The National Audit Office (NAO) is conducting an audit on two additional tranches of MWK 17.2 billion and MWK 5.3 billion COVID-19 spending with a view to finalize the reports by end-December 2021. Implementation of COVID-19 related governance measures committed under Malawi's two RCFs approved in April and October 2020 have been significantly delayed but progress on audits has started as mentioned above. Quarterly statements on commitments and payments of COVID-19 related activities (in all MDAs) have been produced and published for FY19/20 and FY20/21, but with a significant delay due to capacity constraint and specification of COVID-19 related costs in monthly published salary reports have not yet started. Publication of COVID-19 related procurement details, including on beneficial owner(s) of companies awarded contracts, on the Public Procurement and Disposal of Assets Authority (PPDA) website is ongoing but updates are significantly delayed (Annex IX). Meanwhile, the authorities are taking measures to strengthen institutions that have a constitutional mandate to fight corruption, including the Anti-Corruption Bureau, the Financial Intelligence Authority and the PPDA.

50. **The RBM is also taking action to strengthen governance.** The RBM and the Ministry are scaling up internal reconciliation exercises, improving the quality of foreign exchange data, and increasing the frequency of reporting to the IMF. The RBM has committed to conduct a special audit of foreign exchange reserves of the RBM.

Policy Advice

51. **Addressing fiscal governance weaknesses and reducing vulnerabilities to corruption—especially in the PFM, fiscal transparency, and procurement areas—are macro-critical**. Staff underscored the importance of swiftly implementing PFM reforms and start publishing timely comprehensive IFMIS-generated fiscal reports (¶22) which will improve the transparency and accountability of the use of public resources. Staff stressed the need to complete remaining COVID-19 spending audits and take follow-up actions on the findings of the NAO's completed audit reports which pointed to irregularities and mismanagement of COVID-19 related public funds. Staff stand ready to support the authorities' efforts with relevant TA to support auditing of emergency spending. Staff also stand ready to further discuss with the authorities governance issues, including conducting governance diagnostic in the near future.

52. **Staff urged the RBM to strengthen its reserve management and to address governance and control weaknesses identified by the Safeguards Assessment report**. Establishing the Board's Assets and Liabilities Committee (ALCO) and enhancing the Board's oversight of foreign exchange reserve management is critical in avoiding a sharp decline in external buffers observed in 2020-21 (¶7). Staff also reiterated the importance of establishing the RBM's reserve management strategy and continuing to improve the frequency and quality of the RBM's reserve data.

Authorities' Views

53. **The authorities are committed to regular reporting of expenditures and revenues**. As outlined in the recently enacted Access to Information, the authorities are periodically sharing fiscal reports with members of the public or civil society who request such information. On a quarterly basis, the authorities will publish key reports on the internet and other media channels. In addition to specialized audits on COVID-19 responses the authorities have institutionalized audits at local council level and state-owned enterprises which account for large expenditures. The Government of Malawi commits to continue the production and publication of fiscal reports.

54. **The authorities are taking actions following the publication of the NAO's audit report identifying irregularities and mismanagement of COVID-19 related public funds**. The authorities have moved to document the cases and evidence through the audit report with a view of determining the corrective actions, including taking disciplinary or legal measures.

55. **With support from the IMF staff, the authorities are looking into possible noncomplying disbursements**. Noncomplying disbursements ("misreporting") could have resulted from the provision of inaccurate information on the performance criteria on the floor of Net International Reserves (NIR) under the 2018 ECF arrangement. This is a legacy issue which the new administration found and the RBM has started submitting reserve numbers at a higher frequency and improved the quality of data reporting to avoid similar occurrences in the future. The authorities have started reporting data by implementing TA recommendations, including the gross international reserves data following closely the Data Template on International Reserves and Foreign Currency Liquidity (IRFCL) that shows a separate line of the estimated size of pledged deposits. The value of pledged deposits is, however, subject to change upon the completion of the special audit of foreign exchange reserves.

E. Building the Foundation for Growth

Background

56. **Lack of sustained economic growth, in part due to frequent weather-related shocks and fast population increase, has left per capita income stagnant** (Text Figure 1 and Annex V). Extreme weather events are depressing productivity, adversely affecting housing and infrastructure, and risking food security (Annex V). Deforestation, one of key drivers of vulnerability to floods and droughts, is caused not only by tobacco plantations but also by fast growing demand for fuelwoods by Malawi's growing population. Population growth is also putting strains on the schooling system (Annex VI), limiting human capital investment highlighted in the Malawi Vision 2063.

57. **Domestically-financed development expenditure has suffered from cash rationing in the past**. Malawi's growth strategy has been focusing on electricity generation, transportation infrastructure, crop and export diversification, increased access to finance, and investment in human capital. Domestically-financed development expenditure, however, tends to be under-executed: on average, between 2014/15 and 2019/20, domestically financed development expenditure was cut by a third of its budgeted level. Cash rationing and reduction in donor support has seen domestic

development expenditure fall from an average of 1.6 percent of GDP prior to 2013/14 to 0.9 percent of GDP.

Policy Advice

58. **Given Malawi's no fiscal space, prioritizing and improving the efficiency of public sector investment is critically important**. Malawi has significant spending needs on physical and human capital investment and social safety net. Staff called for prioritizing investment in education and building resilience to climate change and weather-related shocks, most notably floods and droughts through strengthening resilience in the agriculture sector, including measures to halt deforestation, safeguarding food security, and developing sustainable energy sources (e.g., solar and renewable energy sources, see Annex VII), while restoring debt sustainability (see DSA).

Authorities' Views

59. **The authorities recognize the importance of creating fiscal space to further invest in education**. Human capital development is identified in Vision 2063 as an enabler for faster economic development, particularly given Malawi's youthful population. At the same time, building resilience to climate change and boosting inclusive growth, entails increasing public investment. Vision 2063 prioritizes development expenditure over non-critical recurrent expenditure.

POST-FINANCING ASSESSMENT

60. **The level of Malawi's outstanding credit to the Fund exceeds 200 percent of quota and therefore requires a Post-Financing Assessment (PFA)** (formerly Post Program Monitoring).[17] Malawi's 2018 ECF provided Fund financing of SDR 78.075 million (56.25 percent of Malawi's quota) which was later augmented by SDR 27.76 million (20 percent of quota) in November 2019.[18] Following the COVID-19 outbreak, Malawi requested two subsequent RCFs in May and October 2020 to address urgent BoP needs related to the spread of the pandemic and economic downturn, providing total access of SDR 138.8 million (100 percent of quota). This elevated use of Fund resources increased Malawi's outstanding credit to the Fund to reach about 206 percent of quota triggering the PFA. Total outstanding credit based on existing drawings to the IMF is about 206 percent of quota, as of mid-November 2021, equivalent to 32 (20.9) percent of exports, and about 95 (69) percent of reserves in 2022 (2024).

[17] The section reports on the discussion under the Post Financing Assessment (PFA) policy which was initiated for Malawi on November 30, 2021. For a description of the PFA policy, see Policy Paper No. 2021/026.

[18] On September 24, 2020, the newly appointed government canceled the ECF arrangement. At the time of cancelation of the ECF, SDR 53.85 million were disbursed. The authorities requested a new four-year ECF arrangement that would be better aligned with Malawi's growth strategy 'Vision 2063'.

61. **Malawi's capacity to repay the Fund is weak under current policies.** Malawi's capacity to repay has deteriorated from strong—at the time of the request for RCF in October 2020—to weak given current policies. This is due to Malawi's macroeconomic imbalances, high debt burden and debt vulnerabilities, and much reduced budget support and other grants financing. These factors contributed to sustained fiscal and current account deficits in the near to medium term, and deterioration in gross reserves which are critically below reserve adequacy levels (see Annex I). Malawi is facing significant financing risks which in turn contributed to Malawi's weak capacity to repay the Fund, these relate to risks of a sudden stop of available financing, especially from RDBs, resulting in rollover risks to external debt, fiscal dominance which undermines effective monetary policy, and delays in external adjustment and reserve accumulation effort.

62. **Upfront policy action to address Malawi's debt vulnerabilities and macroeconomic imbalances as well as intensifying efforts to build buffers would be crucial to help create policy space.** The authorities should allow greater flexibility in the exchange rate to help contain external imbalances and rebuild reserves, thus reduce Malawi's vulnerabilities to external shocks. This should be supported by a well-functioning and transparent foreign exchange interbank market and a foreign exchange reserve management strategy. On the latter, the authorities need to promptly address data shortcoming related to reserves, especially the possible inclusion of encumbered assets that inflate reported reserves. This needs to be supported by upfront policy action to restore debt sustainability over the medium term to moderate risk of debt distress. The authorities need to adopt strong fiscal adjustment program predicated on the following pillars: redoubling efforts on domestic revenue mobilization; reprioritizing expenditure through curtailing growth in wages while safeguarding capital spending, reforming the Affordable Input Program (AIP) and goods and services spending; and strengthening public sector governance and institutions to help safeguard scarce resources and strengthen policy effectiveness.

63. **The authorities concurred with staff assessment**. The authorities are of the view that the Post-Financing Assessment is important considering that the capacity to repay the Fund is currently weak. They broadly concurred with the policies needed to appropriately address risks to Malawi's capacity to repay the IMF. Their detailed views on the proposed policies in case risks materialize (¶62) are presented in paragraphs 28-32.

OTHER ISSUES

64. **An updated safeguards assessment of the RBM is substantially completed.** It found significant deterioration of safeguards at the RBM since the 2018 assessment. Governance arrangements, including Board oversight, and the internal control environment are considered weak. Governance reform should establish the Board as the RBM's main decision-making body responsible for oversight and policy formulation and to introduce collegiality in executive management. Amendments of the central bank legal framework are needed to safeguard the central bank's autonomy and enhance collegiality in executive management. The RBM will also need to strengthen its foreign reserves management practices.

65. **Capacity Development (CD) will be critical in supporting the authorities' reform efforts.** Malawi's capacity needs are guided by the priorities identified in Malawi's Capacity Development Strategy, with due considerations given to absorption capacity (Annex IV). The CD will focus on cash management and reporting within the broad area of PFM; implementing domestic revenue mobilization strategy; improving foreign exchange reserve management; foreign exchange market development; improving central bank operations; and improving necessary trade and monetary and financial statistics; and strengthening debt recording to pave the way for expanding coverage of fiscal and public sector debt statistics to the broader perimeter of government.

66. **Data provided to the Fund have some shortcomings that are serious and significantly hamper surveillance, despite steady improvements in reporting of macroeconomic statistics**. On Malawi's GDP rebasing, staff stress the need to enhance the quality of rebased GDP numbers by improving data sources; reconciling GDP by production and by expenditure approach, and introducing a revision policy in line with international standards (Annex VIII). To strengthen reserve accounting practices the RBM has started to implement the STA TA mission's recommendations on Standardized Report Forms (SRF). The authorities started regular reporting of SRFs to IMF. Public dissemination of which is expected to begin by end-December 2021. Residual issues remain, and STA remains engaged with the authorities to address them.

STAFF APPRAISAL

67. **Malawi's economy has been severely affected by the pandemic and debt burden**. However, there are signs of gradual recovery and daily COVID-19 positive cases remain relatively low. Real GDP growth in 2021 is projected to pick up to 2.2 percent from 0.9 percent in 2020 helped by a good harvest. Inflation is expected to increase to 9 percent in 2021 from 8.6 percent in 2020, driven by increases in prices for fuel, fertilizer and food, leaving per capita growth in the negative region.

68. **Economic growth is projected to recover to reach a small positive per capita growth, but this outlook is predicated on the assumption that external financing from RDBs will continue and thus comes with risks**. President Chakwera's Malawi Vision 2063 aims for the country to reach upper-middle income status by 2063 by investing in physical and human capital. Financing the vision faces challenges. Substantial development and social spending needs, a high debt burden, and much reduced budget support and other grants financing since 2013 are contributing to sustained fiscal and current account deficits in the medium term. The authorities' current policies are focused on a gradual and backloaded pace of fiscal and external adjustment and heavy reliance on nonconcessional borrowing from RDBs to address the large financing needs. This policy mix further elevates risks to the outlook.

69. **Staff urge the authorities to take upfront policy adjustments to address Malawi's macroeconomic imbalances**. The financing gap is estimated at about 4-5 percent of GDP each year, and the external and public debt are assessed to be unsustainable under current policies. The large financing needs in the coming years and low level of international reserves suggest high risk of

future debt distress. The debt burden is projected to crowd out private sector investment and to hinder medium-term economic prospects. Moreover, in spite of emergency RCF assistance in 2020 and SDR allocation in 2021, the RBM's reserve assets are projected to reach 1½ month of next year's imports by end-2021. The main risk to this outlook is a sudden stop of available financing especially from RDBs, and if this materializes, it could lead to an abrupt real exchange rate adjustment, import compression, significant impacts on growth and financial stability, and an adverse effect on the most vulnerable.

70. **Restoring debt sustainability would require both addressing the legacy unsustainable debt burden and a forward-looking anchoring of Malawi's fiscal program** at a minimum reaching a debt stabilizing primary balance so that it can return to a moderate risk of debt distress within the medium term. Malawi's overall and external public debt are assessed to be at high risk of debt distress and unsustainable under current policies. In the near term, priority must be given to expenditure on COVID-19 containment measures and the administration of vaccines. Over the medium term, a strong fiscal adjustment program is needed to stabilize the public debt. Stabilizing public debt within the medium term is critical as delaying adjustment now will exacerbate the eventual adjustment needed. Redoubling efforts on domestic revenue mobilization, reprioritizing expenditure through curtailing growth in wages while safeguarding capital spending, reforming the Affordable Input Program (AIP) and goods and services; and reducing non-critical spending would help in this regard. Moreover, sizeable support from the international community, including the RDBs, in the form of nondebt creating flows (e.g., debt relief and budget support) are vital, as the adjustment alone cannot restore debt sustainability. Realism in budget forecasts and public financial management (PFM) reforms would help contain fiscal deficits and debt.

71. **The RBM should stand ready to tighten monetary policy in the face of inflationary pressures and remain vigilant on financial sector supervision**. To mitigate the adverse impact of COVID-19, RBM adopted an accommodative monetary policy in 2020. Going forward, the monetary program needs to remain anchored on containing reserve money growth and the RBM should remain vigilant to inflationary pressures and stand ready to tighten monetary policy. The RBM should also monitor the RBM's and commercial banks' exposures to the government securities as public debt held by the banking sector is already high.

72. **Allowing for greater flexibility in the exchange rate, containing external imbalances, and rebuilding reserves are critical in reducing Malawi's vulnerabilities to external shocks**. Malawi's external position is assessed to be substantially weaker than the level implied by economic fundamentals and desirable policies. Allowing for greater exchange rate flexibility, and strengthening monetary and fiscal policy, are needed to address foreign exchange shortages and potential inflationary pressures. The surrender requirement reintroduced to address foreign exchange shortages is appropriate only as a temporary measure to address extraordinary circumstances and should be lifted as conditions improve. A well-functioning and transparent foreign exchange interbank market and a foreign exchange reserve management strategy that clarifies the RBM's objectives are also critical. Moreover, there are potential noncomplying disbursements under the 2018 ECF arrangement due to the possible inclusion of encumbered assets

that inflate reported reserves. The authorities have committed to undertake a special audit of foreign exchange reserves. The governance structure under which risks to its reserve position are assessed and managed should be guided by recommendations of the recent IMF Safeguards Assessment.

73. **Strengthening public sector governance and institutions would help safeguard scarce resources and strengthen policy effectiveness**. At the Ministry of Finance and other MDAs, enhancing a robust cash management and control system of the national budget is critical. The publication of comprehensive fiscal reports can also help to further enhance budget transparency and accountability. Moreover, strengthening debt management, monitoring and recording and reporting are critical to boosting public confidence. At the RBM, governance and control issues identified by the recent IMF Safeguards Assessment report, in particular, enhancing the Board's oversight of foreign exchange reserve management as well as improving the frequency and quality of data is important going forward.

74. **The post-financing assessment (PFA) concludes that Malawi's capacity to repay the IMF is weak under current policies**. The assessment reflects Malawi's challenging financing conditions and significant financing needs. It serves to highlight the urgent need to restore debt sustainability, undertake appropriate policy reforms that rebuild fiscal and external buffers and secure support from development partners.

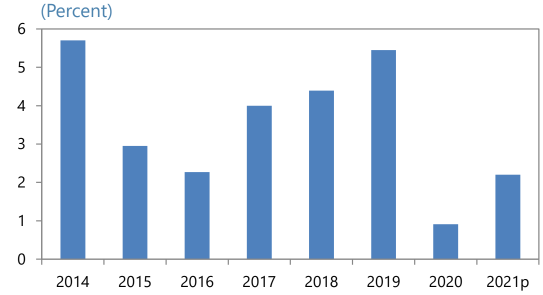
75. **Data provided to the Fund have some shortcomings that are serious and significantly hamper surveillance**. Staff welcomed the increased availability of statistics, especially in the monetary and national accounts. Further efforts across other areas, particularly consolidated fiscal statistics and balance of payments data, especially of foreign exchange reserves data, would be helpful and the IMF stands ready to support these efforts through technical assistance.

76. **It is recommended that the next article IV consultation takes place on the standard 12-month cycle**.

Figure 1. Malawi: Recent Economic Developments, 2000-21

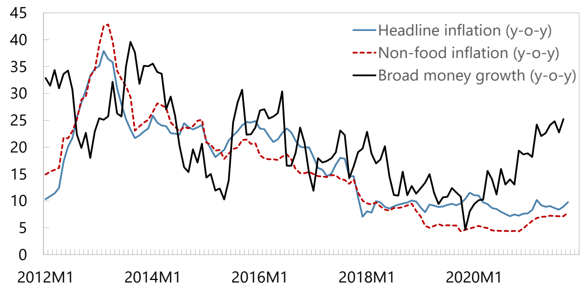
Hard hit by COVID-19, real GDP growth to reach 0.9 percent in 2020 from 5.4 percent in 2019 …

Real GDP Growth, 2014-21
(Percent)



While inflation has been stable, thanks to low food and fuel prices until recently, broad money growth is on the rise.

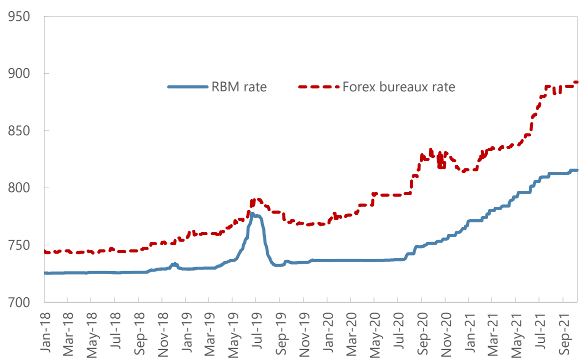
Inflation and Broad Money Growth, 2012-21
(Percent)



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

In turn, pressure on the exchange rate and passthrough effects on inflation are emerging…

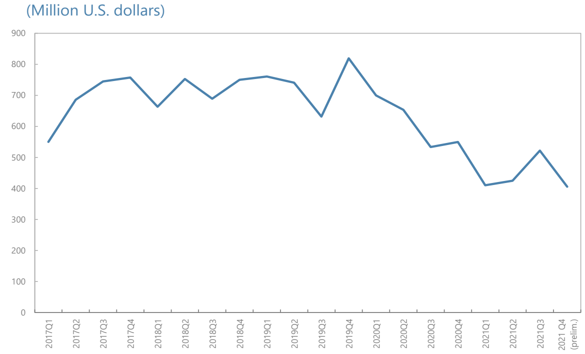
Exchange Rates, 2018-21
(Malawi Kwacha per U.S. dollar)



Source: Reserve Bank of Malawi.

External buffers declined to a critically low level.

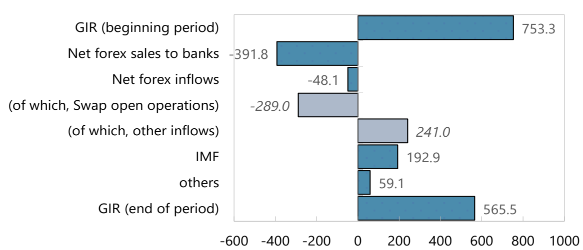
Gross International Reserves, 2017-21
(Million U.S. dollars)



Sources: Reserve Bank of Malawi; and IMF staff calculations

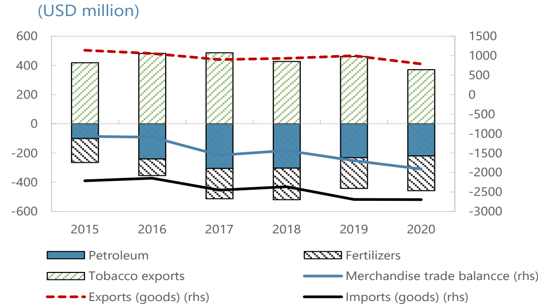
Swap open operations and other FX net outflows were the drivers in the decline in gross official reserves in 2020.

Developments of Gross Official Reserves, 2020
(USD million)



Fuel and fertilizers imports, with stagnant exports, weigh on widening trade and current account balances.

Exports and Imports, 2015-20
(USD million)

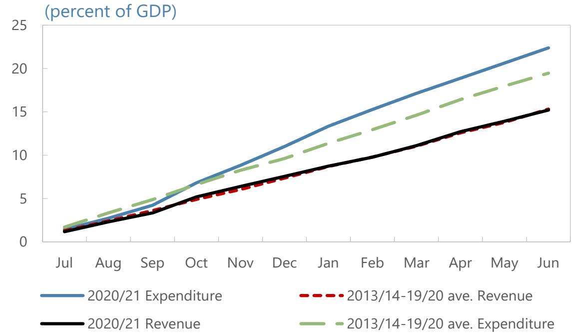


Sources: Reserve Bank of Malawi; Ministry of Finance; and IMF staff estimates.

Figure 2. Malawi: Fiscal Developments and Outlook, 2014–21

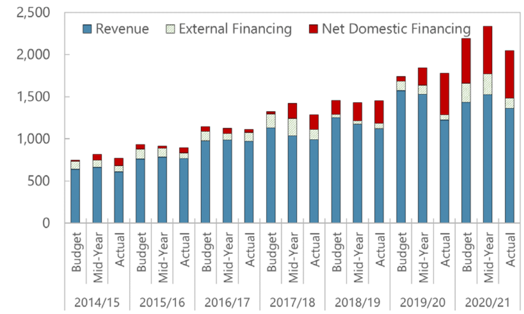
Revenues are holding up, while expenditure is exceeding previous years' average partly due to emergency response.

Revenue and Expenditure, 2013-21
(percent of GDP)



Overly optimistic budget revenue projections and lack of commitment control have led to an increase in net domestic financing.

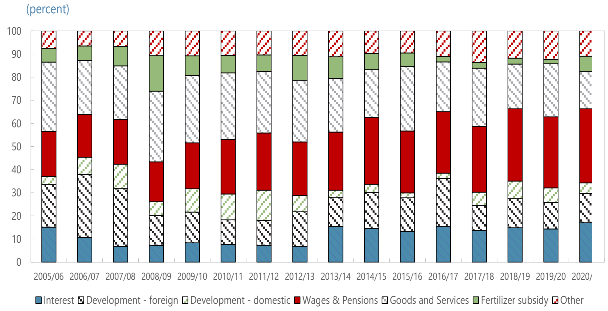
Malawi: Budget versus Outturn, 2014-21
(billion kwacha)



Sources: Malawi Ministry of Finance; and IMF staff calculations.

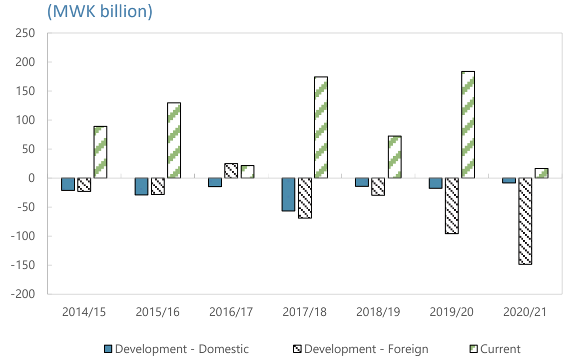
Interest payments and other recurrent spending have increased …

Composition of Expenditure, 2005-21
(percent)



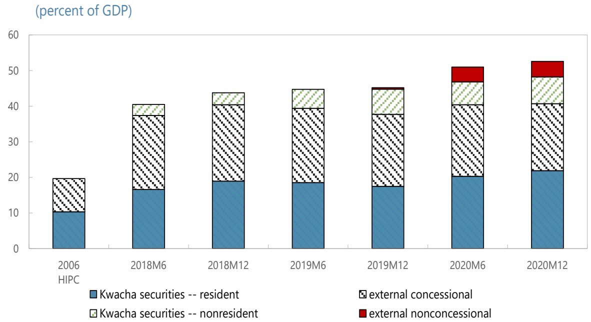
… while capital spending has been under executed.

Difference between Execution and Budgeted, 2014-21
(MWK billion)



Public debt to reach historically high levels.

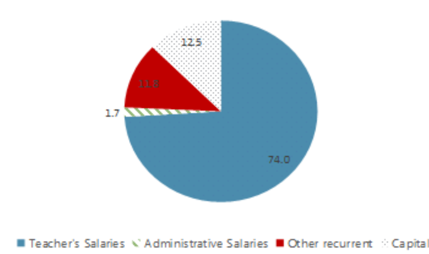
Malawi: Public Debt, 2006-20
(percent of GDP)



Sources: Ministry of Finance; and IMF staff calculations.

Creating fiscal space is important to support investment in education, which will form the foundation of sustainable growth

Composition of Basic and Secondary Education Expenditure, FY2019/20
(percent)



Source: Ministry of Education and UNICEF

Sources: Ministry of Finance; and IMF staff estimates.

Table 1. Malawi: Selected Economic Indicators, 2020–26

	2020	2021			2022	2023	2024	2025	2026
	Est.	RCF II Pre-rebase	RCF II Rebase	Proj.			Proj.		
National accounts and prices (percent change, unless otherwise indicated)									
GDP at constant market prices	0.9	2.2	2.2	2.2	3.5	4.5	4.0	4.0	4.1
Nominal GDP (billions of Kwacha)	8,815	6,933	9,976	9,712	11,114	12,661	14,158	15,663	17,287
GDP deflator	8.5	8.5	8.5	7.8	10.6	9.0	7.5	6.4	6.0
Consumer prices (end of period)	7.6	9.5	9.5	10.0	11.3	9.3	7.8	6.8	6.8
Consumer prices (annual average)	8.6	9.5	9.5	9.0	11.7	9.8	8.4	7.2	6.8
Investment and savings (percent of GDP)									
National savings	-6.0	-5.9	-4.1	-6.5	-4.4	-3.3	-1.2	-0.8	-0.7
Government	-6.1	-13.0	-9.1	-4.7	-5.7	-5.7	-5.8	-5.9	-5.8
Private	0.0	7.2	5.0	-1.7	1.3	2.3	4.6	5.2	5.2
Gross investment	7.5	14.4	10.1	8.6	9.8	9.2	9.6	9.9	9.7
Government	5.4	8.1	5.7	6.1	7.0	6.3	6.5	6.8	6.6
Private	2.2	6.4	4.4	2.5	2.9	2.9	3.0	3.1	3.1
Saving-investment balance	-13.6	-20.3	-14.1	-15.0	-14.3	-12.6	-10.8	-10.7	-10.4
Central government (percent of GDP on a fiscal year basis)[1, 2]									
Revenue	14.9	20.0	14.1	14.8	14.3	14.3	14.4	14.4	14.3
Tax and nontax revenue	13.4	17.4	12.3	13.1	13.1	13.2	13.4	13.5	13.7
Grants	1.5	2.6	1.8	1.7	1.2	1.2	1.1	0.9	0.6
Expenditure and net lending	21.5	33.0	23.1	22.2	24.7	23.8	23.8	24.1	24.7
Overall balance (excluding grants)	-8.1	-15.6	-10.8	-9.1	-11.6	-10.6	-10.4	-10.6	-11.1
Overall balance (including grants)	-6.6	-13.0	-8.9	-7.4	-10.4	-9.5	-9.3	-9.7	-10.4
Foreign financing	0.8	3.2	2.3	1.3	1.2	-0.3	-0.2	0.2	1.2
Total domestic financing	4.0	9.8	6.7	8.1	8.6	5.8	6.9	7.5	9.0
Financing gap/residual gap	0.0	0.0	0.0	0.0	0.8	5.7	6.3	7.5	6.8
Discrepancy	0.8	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Primary balance	-2.7	-7.2	-4.8	-3.7	-6.5	-4.8	-4.2	-4.0	-4.2
Domestic primary balance[3]	-1.7	-4.4	-2.9	-2.5	-5.1	-3.0	-2.5	-2.2	-2.3
Money and credit (change in percent of broad money at the end of the period, unless otherwise indicated)									
Broad money	17.2	10.9	10.9	10.2	14.4	13.9	11.8	10.6	10.6
Net foreign assets	-39.1	4.7	5.0	-19.9	-0.8	1.0	2.1	2.9	2.9
Net domestic assets	56.4	6.2	5.9	30.0	15.2	12.9	9.7	7.7	7.7
o/w Net claims on the government	21.0	14.5	14.5	33.8	7.4	5.9	5.0	3.7	3.5
Credit to the private sector (percent change)	16.4	11.7	11.7	30.1	14.2	12.6	10.1	9.4	7.5
External sector (US$ millions, unless otherwise indicated)									
Exports (goods and services)	966	1,245	1,246	1,078	1,197	1,331	1,522	1,704	1,890
Imports (goods and services)	3,052	3,402	3,410	3,208	3,298	3,262	3,248	3,520	3,693
Gross official reserves	566	958	974	394	402	415	461	498	511
(months of imports)	2.1	3.3	3.4	1.4	1.5	1.5	1.6	1.6	1.6
(percent of reserve money)	127.4	228.7		84.2	84.3	84.5	91.4	95.8	95.4
Current account (percent of GDP)	-13.6	-20.3	-14.1	-15.0	-14.3	-12.6	-10.8	-10.7	-10.4
Current account, excl. official transfers (percent of GDP)	-14.0	-20.3	-14.1	-15.0	-14.2	-12.6	-10.8	-10.7	-10.4
Current account, excl. project related imports (percent of GDP)	-12.0	-16.9	-11.7	-13.4	-12.0	-10.7	-9.1	-9.0	-8.8
Real effective exchange rate (percent change)	…	…	…	…	…	…	…	…	…
Overall balance (percent of GDP)	-3.2	-1.4	0.4	-3.2	-4.2	-3.1	-2.3	-2.4	-3.5
Financing gap	…	…	…	1.8	4.6	3.5	2.9	3.1	4.1
Terms of trade (percent change)	7.6	-1.0	-1.0	-3.8	-1.4	-0.1	-0.9	-1.0	-1.0
Debt stock and service (percent of GDP, unless otherwise indicated)									
External debt (public sector)	32.9	34.4	24.1	31.9	34.7	36.3	37.6	39.5	41.5
NPV of public external debt (percent of exports)	171.6	148.6	149.3	153.5	169.9	179.6	25.0	26.5	27.9
Domestic public debt	21.9	43.7	30.1	27.1	29.5	32.6	36.8	40.9	44.2
Total public debt	54.8	78.2	54.2	59.0	64.3	68.9	74.4	80.4	85.7
External debt service (percent of exports)	7.2	8.8	8.8	47.2	44.1	40.8	35.7	28.1	33.3
External debt service (percent of revenue excl. grants)	1.6	6.6	6.5	2.1	2.0	1.8	1.5	1.5	1.6
91-day treasury bill rate (end of period)	10.0	…	…	…	…	…	…	…	…

Sources: Malawian authorities and IMF staff estimates and projections.

[1]The current financial year, 2021, runs from July 1, 2020 to June 30, 2021. FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year starting from FY2022/23.

[2]Please note that government fiscal statistics are reported following the Government Finance Statistics Manual (2014) starting 2020 projections and going forward.

[3]Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and nontax revenues.

Table 2a. Malawi: Central Government Operations, 2018/19-25/26[1]

(Billion of Kwacha)

	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	2024/25	2025/26
			Prelim.	Budget			Proj.		
REVENUE	1,132.6	1,263.8	1,363.8	1,271.3	1,102.4	1,637.0	1,870.6	2,085.1	2,287.5
Taxes	986.7	1,068.7	1,136.0	1,044.1	978.0	1,451.9	1,666.8	1,877.3	2,103.7
Taxes on income profits and capital gains	460.7	506.6	539.9	495.8	455.9	677.7	778.7	878.8	986.5
Taxes on goods and services	437.0	476.6	502.7	464.4	434.0	644.5	739.8	831.9	930.6
Taxes on international trade and transaction	88.3	84.7	92.5	83.1	87.4	128.6	147.0	165.2	185.0
Other taxes	0.7	0.9	0.9	0.7	0.7	1.1	1.2	1.4	1.5
Grants	109.3	126.6	157.9	170.3	91.7	132.8	137.5	133.6	101.7
Current	30.7	22.0	16.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital	78.6	104.6	141.9	170.3	91.7	132.8	137.5	133.6	101.7
Project grants	51.5	86.1	116.7	…	49.2	99.6	103.1	100.2	76.2
Dedicated Grants	27.0	18.6	25.2	…	42.5	33.2	34.4	33.4	25.4
Other Revenue	36.7	68.5	69.9	56.9	32.7	52.3	66.4	74.1	82.1
EXPENDITURE	1,509.3	1,822.8	2,049.7	1,995.1	1,903.3	2,718.1	3,080.8	3,489.7	3,958.3
EXPENSE	1,204.2	1,499.5	1,695.6	1,424.3	1,507.4	2,168.1	2,477.0	2,789.9	3,170.0
Compensation of employees	398.7	473.6	552.9	449.6	462.2	695.3	814.8	932.1	1,048.4
Purchase of goods and services	292.5	418.0	329.6	269.6	272.2	346.7	368.7	386.9	461.4
Generic goods and services	131.5	219.6	212.2	164.8	167.1	214.9	219.4	220.3	219.2
Health Sector	42.8	64.4	57.5	49.0	49.0	67.8	76.9	85.8	94.9
Agriculture Sector	6.3	8.6	7.3	5.0	6.8	8.8	10.0	11.1	12.3
Education Sector	26.8	27.8	34.2	29.8	29.8	39.3	44.5	49.7	54.9
Expenditure for arrears	5.2	54.3	2.9	5.0	5.0	0.0	0.0	0.0	0.0
Storage levy expenses	2.0	2.9	1.6	2.9	1.3	1.9	2.2	2.4	2.7
Maize purchases	8.7	10.0	10.4	12.0	12.0	12.4	14.1	15.7	17.4
Other	69.3	30.4	3.6	1.2	1.2	1.6	1.6	0.0	0.1
Interest	224.3	261.7	348.3	299.7	293.4	536.9	671.2	829.7	993.2
To non-residents	15.6	15.3	17.7	14.5	92.9	151.0	166.5	168.5	134.5
To residents other than general government	208.7	246.4	330.6	285.3	200.5	385.8	504.7	661.2	858.7
Grants	171.4	211.8	191.2	154.0	167.8	230.5	247.8	257.2	257.2
Current	124.3	164.2	168.9	141.7	147.6	205.0	220.1	229.5	238.5
Road fund Administration	21.2	39.1	32.9	31.3	27.7	40.8	46.3	51.6	57.1
Transfers to MRA	28.8	31.3	31.5	31.0	29.3	43.6	50.0	56.3	63.1
Transfers to public entities	74.3	93.8	104.4	79.4	90.6	120.6	123.8	121.5	118.3
Capital	47.1	47.6	22.3	9.0	20.2	25.5	27.7	27.7	18.7
Rural electrification programme	39.1	38.6	13.3	…	11.2	16.5	18.7	18.7	18.7
Net Lending	8.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	0.0
Social Benefits	110.9	124.8	244.4	221.8	287.2	334.6	347.0	353.4	376.0
Social assistance benefits	38.6	37.9	141.2	144.2	204.0	212.1	216.3	216.4	233.6
Fertiliser payments[2]	28.4	30.1	121.1	129.7	189.0	196.0	200.6	201.2	217.0
Maize seed subsidy[2]	10.2	5.4	17.0	12.3	12.5	12.4	11.5	10.5	11.4
Social Cash Transfer-Government	0.0	2.5	3.0	2.3	2.5	3.7	4.2	4.7	5.2
Pensions and gratuities	72.3	86.9	103.3	77.6	83.2	122.5	130.6	137.0	142.4
Other Expenses	6.4	9.5	29.2	29.5	24.6	24.2	27.5	30.6	33.9
Acquisition of Non-Financial Assets									
(Development Expenditure)	305.1	323.4	354.1	570.8	395.9	550.0	603.8	699.8	788.3
Foreign (Part I)	189.4	210.1	261.6	351.2	201.3	329.5	358.7	385.3	405.8
Domestic (Part II)	115.7	113.2	92.6	219.6	194.6	220.5	245.1	314.5	382.5
Discrepancy	5.3	64.8	-4.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (incl. grants and discrepancy)	-371.3	-494.2	-690.7	-723.8	-798.5	-1,081.1	-1,210.2	-1,404.6	-1,670.8
Primary Balance	-147.0	-231.7	-337.6	-424.1	-505.1	-544.2	-538.9	-574.9	-677.6
Domestic Primary Balance[3]	-66.9	-148.1	-233.9	-243.2	-395.6	-347.5	-317.8	-323.3	-373.5
NET FINANCING (Repayment if negative)	371.3	494.2	690.7	723.8	800.9	1,081.1	1,210.2	1,404.6	1,670.8
Net Acquisition of Financial Assets	137.6	-94.2	68.9	…	0.0	0.0	0.0	0.0	0.0
Domestic Creditors	0.0	0.0	…	…	…	…	…	…	…
Currency and deposits	137.6	-94.2	…	…	…	…	…	…	…
Deposits Monetary	132.1	-83.0	…	…	…	…	…	…	…
Deposits Commercial banks	5.5	-11.3	…	…	…	…	…	…	…
Net Incurrence of Liabilities	508.9	400.0	759.6	723.8	800.9	1,081.1	1,210.2	1,404.6	1,670.8
Total Financing	508.9	400.0	759.6	723.8	738.7	433.6	397.1	318.8	576.8
Foreign financing (net)	79.7	70.8	119.8	134.8	95.6	-34.1	-23.0	32.2	199.1
Loans	79.7	70.8	119.8	180.9	95.6	-34.1	-23.0	32.2	199.1
Programme Borrowing	0.0	0.0	51.7	0.0	149.0	0.0	0.0	0.0	0.0
Project Loans	99.6	105.4	110.1	180.9	109.5	196.7	221.2	251.6	304.1
Other concessional loans	11.3	0.1	0.0	…	0.0	0.0	0.0	0.0	0.0
Non-concessional loans	0.0	0.0	0.0	…	0.0	0.0	0.0	0.0	0.0
Amortisation	-31.2	-34.7	-42.0	-46.2	-162.9	-230.7	-244.2	-219.4	-105.0
Domestic financing (net)	429.3	329.1	749.3	589.1	643.1	467.6	420.1	286.6	377.7
Debt Instruments	429.3	329.1	749.3	…	643.1	467.6	420.1	286.6	377.7
Banking system	258.5	236.9	…	…	…	…	…	…	…
Gross borrowing Monetary	52.8	9.1	…	…	…	…	…	…	…
Gross borrowing Commercial banks	205.8	227.8	…	…	…	…	…	…	…
Nonbank sector	245.8	101.7	…	…	…	…	…	…	…
Zero coupon promissory notes			109.6	…	35.3	0.0	0.0	0.0	0.0
Amortization	-75.1	-9.4	0.0	…	-20.6	-196.1	-471.7	-798.6	-1,067.7
Financing Gap					59.8	647.5	813.1	1,085.8	1,094.1

Sources: Malawi Ministry of Finance and IMF staff projections.

[1] FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year starting from FY2022/23

[2] Farm Input Subsidy Program prior to FY20/21

[3] Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and nontax revenues.

Table 2b. Malawi: Central Government Operations, 2018/19-25/26[1]

(Percent of GDP)

	2018/19	2019/20	2020/21	2021/22				2022/23	2023/24	2024/25	2025/26
			Prelim.	RCF II Pre-rebase	RCF II Rebase	Budget	Proj.	Proj.			
REVENUE	14.7	14.9	14.8	21.3	15.2	16.5	14.3	14.3	14.4	14.4	14.3
Taxes	12.8	12.6	12.3	17.6	12.6	13.5	12.7	12.7	12.9	13.0	13.2
Taxes on income profits and capital gains	6.0	6.0	5.9	7.7	5.4	6.4	5.9	5.9	6.0	6.1	6.2
Taxes on goods and services	5.7	5.6	5.4	8.5	6.1	6.0	5.6	5.6	5.7	5.8	5.8
Taxes on international trade and transaction	1.1	1.0	1.0	1.4	1.0	1.1	1.1	1.1	1.1	1.1	1.2
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	1.4	1.5	1.7	2.6	1.9	2.2	1.2	1.2	1.1	0.9	0.6
Current	0.4	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital	1.0	1.2	1.5	2.6	1.9	2.2	1.2	1.2	1.1	0.9	0.6
Project grants	0.7	1.0	1.3	1.6	1.2	…	0.6	0.9	0.8	0.7	0.5
Dedicated Grants	0.4	0.2	0.3	1.0	0.7	…	0.6	0.3	0.3	0.2	0.2
Other Revenue	0.5	0.8	0.8	1.0	0.8	0.7	0.4	0.5	0.5	0.5	0.5
EXPENDITURE	19.6	21.5	22.2	32.6	23.0	25.9	24.7	23.8	23.8	24.1	24.7
EXPENSE	15.7	17.7	18.4	25.4	17.8	18.5	19.5	19.0	19.1	19.3	19.8
Compensation of employees	5.2	5.6	6.0	8.0	5.6	5.8	6.0	6.1	6.3	6.4	6.6
Purchase of goods and services	3.8	4.9	3.6	4.6	3.2	3.5	3.5	3.0	2.8	2.7	2.9
Generic goods and services	1.7	2.6	2.3	2.8	1.8	2.1	2.2	1.9	1.7	1.5	1.4
Health Sector	0.6	0.8	0.6	0.9	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Agriculture Sector	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Education Sector	0.3	0.3	0.4	0.5	0.3	0.4	0.4	0.3	0.3	0.3	0.3
Expenditure for arrears	0.1	0.6	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Storage levy expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maize purchases	0.1	0.1	0.1	0.2	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest	2.9	3.1	3.8	5.4	3.8	3.9	3.8	4.7	5.2	5.7	6.2
To non-residents	0.2	0.2	0.2	0.3	0.2	0.2	1.2	1.3	1.3	1.2	0.8
To residents other than general government	2.7	2.9	3.6	5.1	3.6	3.7	2.6	3.4	3.9	4.6	5.4
Grants	2.2	2.5	2.1	3.3	2.3	2.0	2.2	2.0	1.9	1.8	1.6
Current	1.6	1.9	1.8	2.6	1.9	1.8	1.9	1.8	1.7	1.6	1.5
Road fund Administration	0.3	0.5	0.4	0.7	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Transfers to MRA	0.4	0.4	0.3	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Transfers to public entities	1.0	1.1	1.1	1.5	1.1	1.0	1.2	1.1	1.0	0.8	0.7
Capital	0.6	0.6	0.2	0.6	0.4	0.1	0.3	0.2	0.2	0.2	0.1
Rural electrification programme	0.5	0.5	0.1	0.6	0.4	…	0.1	0.1	0.1	0.1	0.1
Net Lending	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.0
Social Benefits	1.4	1.5	2.6	4.1	2.9	2.9	3.7	2.9	2.7	2.4	2.4
Social assistance benefits	0.5	0.4	1.5	2.6	1.8	1.9	2.6	1.9	1.7	1.5	1.5
Fertiliser payments[2]	0.4	0.4	1.3	2.0	1.4	1.7	2.4	1.7	1.5	1.4	1.4
Maize seed subsidy[2]	0.1	0.1	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Social Cash Transfer-Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pensions and gratuities	0.9	1.0	1.1	1.5	1.1	1.0	1.1	1.1	1.0	0.9	0.9
Other Expenses	0.1	0.1	0.3	0.1	0.1	0.4	0.3	0.2	0.2	0.2	0.2
Acquisition of Non-Financial Assets (Development Expenditure)	4.0	3.8	3.8	7.2	5.2	7.4	5.1	4.8	4.7	4.8	4.9
Foreign (Part I)	2.5	2.5	2.8	5.1	3.7	4.6	2.6	2.9	2.8	2.7	2.5
Domestic (Part II)	1.5	1.3	1.0	2.1	1.6	2.8	2.5	1.9	1.9	2.2	2.4
Discrepancy	0.1	0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (incl. grants and discrepancy)	-4.8	-5.8	-7.5	-11.4	-7.8	-9.4	-10.3	-9.5	-9.3	-9.7	-10.4
Primary Balance	-1.9	-2.7	-3.7	-6.0	-4.0	-5.5	-6.5	-4.8	-4.2	-4.0	-4.2
Domestic Primary Balance[3]	-0.9	-1.7	-2.5	-3.5	-2.2	-3.2	-5.1	-3.0	-2.5	-2.2	-2.3
NET FINANCING (Repayment if negative)	4.8	5.8	7.5	11.4	7.8	9.4	10.4	9.5	9.3	9.7	10.4
Net Acquisition of Financial Assets	1.8	-1.1	0.7	0.0	0.0	…	0.0	0.0	0.0	0.0	0.0
Domestic Creditors	0.0	0.0	…	…	…	…	…	…	…	…	…
Currency and deposits	1.8	-1.1	…	…	…	…	…	…	…	…	…
Deposits Monetary	1.7	-1.0	…	…	…	…	…	…	…	…	…
Deposits Commercial banks	0.1	-0.1	…	…	…	…	…	…	…	…	…
Net Incurrence of Liabilities	6.6	4.7	8.2	11.4	7.8	9.4	10.4	9.5	9.3	9.7	10.4
Total Financing	6.6	4.7	8.2	11.4	7.8	9.4	9.6	3.8	3.1	2.2	3.6
Foreign financing (net)	1.0	0.8	1.3	1.7	1.3	1.7	1.2	-0.3	-0.2	0.2	1.2
Loans	1.0	0.8	1.3	1.7	1.3	2.3	1.2	-0.3	-0.2	0.2	1.2
Programme Borrowing	0.0	0.0	0.6	0.0	0.0	0.0	1.9	0.0	0.0	0.0	0.0
Project Loans	1.3	1.2	1.2	2.4	1.7	2.3	1.4	1.7	1.7	1.7	1.9
Other concessional loans	0.1	0.0	0.0	0.1	0.1	…	0.0	0.0	0.0	0.0	0.0
Non-concessional loans	0.0	0.0	0.0			…	0.0	0.0	0.0	0.0	0.0
Amortisation	-0.4	-0.4	-0.5	-0.8	-0.5	-0.6	-2.1	-2.0	-1.9	-1.5	-0.7
Domestic financing (net)	5.6	3.9	8.1	9.6	6.5	7.6	8.3	4.1	3.2	2.0	2.4
Debt Instruments	5.6	3.9	8.1	9.6	6.5	…	8.3	4.1	3.2	2.0	2.4
Banking system	3.4	2.8	…	…	…	…	…	…	…	…	…
Gross borrowing Monetary	0.7	0.1	…	…	…	…	…	…	…	…	…
Gross borrowing Commercial banks	2.7	2.7	…	…	…	…	…	…	…	…	…
Nonbank sector	3.2	1.2	…	…	…	…	…	…	…	…	…
Zero Coupon Promissory Note			1.2			…	0.5	0.0	0.0	0.0	0.0
Amortization	-1.0	-0.1	0.0	-2.3	-1.6	…	-0.3	-1.7	-3.6	-5.5	-6.7
Financing Gap					0.0		0.8	5.7	6.3	7.5	6.8

Sources: Malawi Ministry of Finance and IMF staff projections.

[1] FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year starting from FY2022/23.

[2] Farm Input Subsidy Program prior to FY20/21

[3] Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and nontax revenues.

Table 3a. Malawi: Central Bank Survey, 2020–26

(Billions of Kwacha, unless otherwise indicated)

	2020				2021				2022	2023	2024	2025	2026
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.					
	Est.		Proj.		Est.		Proj.				Proj.		
Monetary base	312	324	315	342	318	400	366	390	446	508	568	629	694
Currency in circulation	217	277	259	284	257	341	...	...	...	...	...	...	...
Liabilities to other depository corporations	72	45	55	57	58	58	...	...	...	...	...	...	...
Liabilities to other sectors	23	1	1	1	3	1	...	...	...	...	...	...	...
Net foreign assets (NFA) [1]	258	-150	-251	-303	-405	-394	-189	-542	-562	-550	-508	-441	-364
Claims on nonresidents	538	505	419	452	328	353	627	603	685	792	914	1,026	1,115
Liabiliites to nonresidents	-280	-655	-670	-755	-733	-748	-816	-1,146	-1,248	-1,341	-1,422	-1,467	-1,478
Net domestic assets	54	474	567	645	723	795	554	932	1,009	1,058	1,076	1,070	1,058
Net claims on central government	250	432	382	409	440	355	355	355	355	355	355	355	355
Claims on central government	2,283	2,521	2,466	2,831	2,983	3,026	...	...	...	...	...	...	...
Liabilities to central government	2,033	2,089	2,084	2,422	2,542	2,671	...	...					
Claims on other depository corporations	29	9	9	9	10	9	...	...	...	...	...	...	...
Claims on public nonfinancial corportions	0	0	0	0	0	0	...	...	...	...	...	...	...
Claims on private sector	586	611	662	693	697	776	...	...	...	...	...	...	...
Other items (net)	-812	-579	-488	-466	-424	-346	-616	-325	-376	-456	-554	-680	-798
Memorandum items:													
Money multiplier	4.2	4.4	4.6	4.5	5.1	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Annual growth of reserve money (percent)	14.1	4.8	-4.6	12.8	2.0	23.6	16.0	14.0	14.4	13.9	11.8	10.6	10.4
91-day treasury bill rate	7.5	7.6	9.9	9.9	10.0	10.0	...	...	...	...	...	...	...
NFA of the central bank (US$ millions)	-91	-626	-655	-532	-511	-490	-231	-651	-601	-531	-451	-365	-281
Foreign assets (US$ millions)	260	192	179	405	395	431	767	724	732	765	811	848	861
Foreign liabilities (US$ millions)	-351	-818	-835	-936	-906	-921	-998	-1,375	-1,333	-1,295	-1,261	-1,212	-1,142

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

[1] Including SDR allocation and the entire assets and liabilities of the RBM.

Table 3b. Malawi: Depository Corporations Survey, 2020–26

(Billions of Kwacha, unless otherwise indicated)

	2020				2021				2022	2023	2024	2025	2026
	Mar.	June.	Sept.	Dec.	Mar.	June.	Sept.	Dec.					
	Est.		Proj.			Proj.							
Broad money liabilities	1,320	1,410	1,456	1,541	1,614	1,744	1,593	1,698	1,943	2,214	2,476	2,739	3,023
Currency outside depository corporations	822	890	884	949	959	1,096	…	…	…	…	…	…	…
Transferable deposits	498	520	572	592	655	648	…	…	…	…	…	…	…
Other deposits	0	0	0	0	0	0	…	…	…	…	…	…	…
Net foreign assets (NFA)	222	-147	-233	-183	-302	-269	-136	-489	-503	-483	-436	-364	-147
Monetary authorities	258	-150	-251	-303	-405	-394	-189	-542	-562	-550	-508	-441	-364
Gross foreign assets	538	505	419	452	328	353	627	603	685	792	914	1,026	1,115
Foreign liabilities	-280	-655	-670	-755	-733	-748	-816	-1,146	-1,248	-1,341	-1,422	-1,467	-1,478
Commercial banks (net)	-37	3	18	120	103	125	52	53	60	66	72	77	217
NFA of the commercial banks (US$ millions)	-46	4	23	149	128	154	64	64	64	64	64	64	168
Gross foreign assets (US$ millions)	84	156	183	238	203	255	116	116	116	116	116	116	116
Foreign liabilities (US$ millions)	-130	-152	-160	-89	-76	-101	-52	-52	-52	-52	-52	-52	52
Domestic Claims	1,098	1,556	1,689	1,724	1,916	2,013	1,730	2,187	2,446	2,697	2,911	3,103	3,169
Net claims on central government	778	985	961	977	1,211	1,186	1,303	1,497	1,624	1,738	1,848	1,939	1,985
Claims on central government	2,283	2,521	2,466	2,831	2,983	3,026	54	58	46	54	65	65	65
Liabilities to central government	2,033	2,089	2,084	2,422	2,542	2,671	…	…	…	…	…	…	…
Claims on other sectors	615	621	673	701	706	786	…	…	…	…	…	…	…
Claims on other financial corporations	29	9	9	9	10	9	…	…	…	…	…	…	…
Claims on public nonfinancial corporations	0	1	2	0	0	0	…	…	…	…	…	…	…
Claims on private sector	586	611	662	693	697	776	…	…	…	…	…	…	…
Other items (net)	-812	-579	-488	-466	-424	-346	-616	-325	-376	-456	-554	-680	-798
Memorandum items:													
Velocity of money (annualized GDP divided by broad money)	6.3	6.0	5.9	5.7	5.6	5.3	5.9	5.7	5.7	5.7	5.7	5.7	5.7
Annual growth of broad money (percent)	7.5	6.8	12.1	17.2	22.3	32.1	13.0	16.6	14.4	13.9	11.8	10.6	10.4
Annual growth of credit to the private sector (percent)[1]	22.1	12.1	15.6	16.4	18.9	27.0	23.1	30.1	14.2	12.6	10.1	9.4	7.5
NFA of the commercial banks (US$ millions)	-46.0	4.1	23.0	148.8	127.7	154.5	63.9	63.9	63.9	63.9	63.9	63.9	167.6
Gross foreign assets (US$ millions)	83.8	155.9	183.1	237.5	203.4	255.5	115.7	115.7	115.7	115.7	115.7	115.7	115.7
Foreign liabilities (US$ millions)	-129.8	-151.8	-160.1	-88.8	-75.7	-101.0	-51.8	-51.8	-51.8	-51.8	-51.8	-51.8	51.8
Nominal GDP (billions of Kwacha)	8,343	8,495	8,651	8,815	9,000	9,229	9,465	9,712	11,114	12,661	14,158	15,663	17,287

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

[1] Different treatment of external debt of reserve bank of Malawi between the past and projection periods leads to a surge in credit to private sector in 2021. This will be fixed after TA mission on the treatment of external debt.

Table 4a. Malawi: Balance of Payments, 2019–26

(Millions of U.S. dollars, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026
	Est.	Est.	Proj.			Proj.		
Current account balance	-1,389.9	-1,606.7	-1,819.3	-1,792.4	-1,614.5	-1,414.0	-1,433.6	-1,436.0
Merchandise trade balance	-1,696.6	-1,911.5	-2,061.6	-2,024.3	-1,850.4	-1,649.1	-1,681.9	-1,683.6
Exports	996.8	784.8	892.6	1,005.4	1,130.7	1,313.1	1,487.2	1,664.0
Of which: Tobacco	460.6	370.5	388.5	398.9	416.8	433.0	455.3	483.1
Imports	-2,693.3	-2,696.3	-2,954.2	-3,029.7	-2,981.0	-2,962.2	-3,169.1	-3,347.6
Of which: Petroleum products	-232.0	-220.2	-292.0	-288.8	-289.4	-293.7	-305.6	-317.9
Of which: Fertilizers	-211.1	-238.4	-250.3	-260.3	-268.1	-276.2	-287.3	-296.0
Of which: Project related	-195.3	-185.5	-202.6	-285.2	-232.9	-223.0	-227.7	-216.5
Services balance	-332.9	-353.3	-394.1	-441.0	-481.1	-510.7	-527.3	-559.9
Unrequited transfers (net)	639.6	658.1	636.4	672.9	717.0	745.8	775.6	807.5
Capital account balance[1]	938.0	1,036.9	1,110.4	1,052.3	978.9	840.2	713.0	628.3
Project and dedicated grants	143.8	156.2	152.4	147.0	138.5	124.7	94.1	77.8
Off-budget project support[2]	794.1	880.7	958.0	905.3	840.4	715.5	618.9	550.5
Financial account balance[1]	434.2	354.0	322.1	208.2	236.0	273.3	395.4	327.6
Foreign direct investment (net)	104.8	91.8	93.8	157.4	160.9	164.0	182.8	198.3
Portfolio investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medium- and long-term loans (net)	131.3	104.2	228.4	4.0	28.1	58.0	157.3	-35.5
SDR allocation	0.0	0.0	190.0	0.0	0.0	0.0	0.0	0.0
Disbursements	159.5	182.0	360.8	225.2	230.6	229.8	267.0	265.6
Budget support and other program loans	0.0	29.9	191.6	0.0	0.0	0.0	0.0	0.0
Project support	156.7	129.1	159.3	214.9	219.8	218.3	256.2	255.2
Other medium-term loans	2.9	4.9	9.9	10.4	10.8	11.4	10.9	10.5
Amortization	-28.2	-55.9	-357.8	-314.0	-256.5	-139.7	89.0	126.4
Other inflows	198.1	158.1	-0.1	46.7	47.0	51.3	55.3	164.8
Errors and omissions	-6.1	-161.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-23.8	-377.0	-386.8	-531.9	-399.6	-300.4	-325.1	-480.1
Financing	23.8	377.0	386.8	531.9	399.6	300.4	325.1	480.1
Gross reserves (- increase)	-3.2	187.8	171.5	-7.8	-12.8	-46.3	-36.9	-13.8
IMF (net)	27.0	189.2	0.0	-37.1	-32.6	-33.8	-49.0	-70.0
Purchases/drawings	43.4	192.8	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases/repayments	16.4	18.4	26.2	37.1	32.6	33.8	49.0	70.0
Exceptional financing		14.7	26.2	0.0				
Financing gap	...	0.0	215.3	576.8	444.9	380.5	411.0	563.9
Memorandum items:								
Gross official reserves	753.3	565.5	394.0	401.8	414.6	460.9	497.7	511.5
Months of imports[3]	3.0	2.1	1.4	1.5	1.5	1.6	1.6	1.6
Current account balance (percent of GDP)	-12.6	-13.6	-15.0	-14.3	-12.6	-10.8	-10.7	-10.4
Excluding official transfers	-13.0	-14.0	-15.0	-14.2	-12.6	-10.8	-10.7	-10.4
Excluding project related imports	-10.8	-12.0	-13.4	-12.0	-10.7	-9.1	-9.0	-8.8
Excluding official transfers and project related imports	-11.2	-12.4	-13.3	-12.0	-10.7	-9.1	-9.0	-8.8
Import price index (2005 = 100)	113.7	106.1	116.8	50.0	50.1	80.1	33.3	83.8
Import volume (percent change)	14.3	7.3	-0.5	-193.0	50.1	80.1	85.8	83.8
REER (percent change)	13.9	...	...	...	...	...	...	...
Overall balance (percent of GDP)	-0.2	-3.2	-3.2	-4.2	-3.1	-2.3	-2.4	-3.5
Terms of trade (percent change)	-1.3	7.6	-3.8	-1.4	-0.1	-0.9	-1.0	-1.0
Nominal GDP (millions of U.S. dollars)	11,031	11,847	12,108	12,577	12,855	13,102	13,408	13,812

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

[1]The IMF has adopted the Malawi National Statistics Office (NSO)'s capital and financial account data following adoption of the NSO's current account data in 2019. Previously, the IMF's reported series was based on staff estimates. Consequently, the IMF's reported capital account balance increased from 3.8 percent of GDP to 11.7 percent of GDP in 2018 while financial account balance including net errors and omission decreased from 16.5 percent of GDP to 8.6 percent of GDP.

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

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

Table 4b. Malawi: Balance of Payments, 2019–26
(Percent of GDP)

	2019	2020	2021	2022	2023	2024	2025	2026
	Est.	Est.	Proj.			Proj.		
Current account balance	-12.6	-13.6	-15.0	-14.3	-12.6	-10.8	-10.7	-10.4
Merchandise trade balance	-15.4	-16.1	-17.0	-16.1	-14.4	-12.6	-12.5	-12.2
Exports	9.0	6.6	7.4	8.0	8.8	10.0	11.1	12.0
Of which: Tobacco	4.2	3.1	3.2	3.2	3.2	3.3	3.4	3.5
Imports	-24.4	-22.8	-24.4	-24.1	-23.2	-22.6	-23.6	-24.2
Of which: Petroleum products	-2.1	-1.9	-2.4	-2.3	-2.3	-2.2	-2.3	-2.3
Of which: Fertilizers	-1.9	-2.0	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Of which: Project related	-1.8	-1.6	-1.7	-2.3	-1.8	-1.7	-1.7	-1.6
Services balance	-3.0	-3.0	-3.3	-3.5	-3.7	-3.9	-3.9	-4.1
Unrequited transfers (net)	5.8	5.6	5.3	5.4	5.6	5.7	5.8	5.8
Capital account balance[1]	8.5	8.8	9.2	8.4	7.6	6.4	5.3	4.5
Project and dedicated grants	1.3	1.3	1.3	1.2	1.1	1.0	0.7	0.6
Off-budget project support[2]	7.2	7.4	7.9	7.2	6.5	5.5	4.6	4.0
Financial account balance[1]	3.9	3.0	2.7	1.7	1.8	2.1	2.9	2.4
Foreign direct investment (net)	1.0	0.8	0.8	1.3	1.3	1.3	1.4	1.4
Portfolio investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medium- and long-term loans (net)	1.2	0.9	1.9	0.0	0.2	0.4	1.2	-0.3
SDR allocation	0.0	0.0	1.6	0.0	0.0	0.0	0.0	0.0
Disbursements	1.4	1.5	3.0	1.8	1.8	1.8	2.0	1.9
Budget support and other program loans	0.0	0.3	1.6	0.0	0.0	0.0	0.0	0.0
Project support	1.4	1.1	1.3	1.7	1.7	1.7	1.9	1.8
Other medium-term loans	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Amortization	-0.3	-0.5	-3.0	-2.5	-2.0	-1.1	0.7	0.9
Other inflows	1.8	1.3	0.0	0.4	0.4	0.4	0.4	1.2
Errors and omissions	-0.1	-1.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.2	-3.2	-3.2	-4.2	-3.1	-2.3	-2.4	-3.5
Financing	0.2	3.2	3.2	4.2	3.1	2.3	2.4	3.5
Gross reserves (- increase)	0.0	1.6	1.4	-0.1	-0.1	-0.4	-0.3	-0.1
IMF (net)	0.2	1.6	0.0	-0.3	-0.3	-0.3	-0.4	-0.5
Purchases/drawings	0.4	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases/repayments	0.1	0.2	0.2	0.3	0.3	0.3	0.4	0.5
Exceptional financing	0.0	0.1	0.2	0.0	0.0	0.0	0.0	0.0
Financing gap		0.0	1.8	4.6	3.5	2.9	3.1	4.1
Memorandum items:								
Gross official reserves	6.8	4.8	3.3	3.2	3.2	3.5	3.7	3.7
Months of imports[3]	3.0	2.1	1.4	1.5	1.5	1.6	1.6	1.6
Current account balance (percent of GDP)	-12.6	-13.6	-15.0	-14.3	-12.6	-10.8	-10.7	-10.4
Excluding official transfers	-13.0	-14.0	-15.0	-14.2	-12.6	-10.8	-10.7	-10.4
Excluding project related imports	-10.8	-12.0	-13.4	-12.0	-10.7	-9.1	-9.0	-8.8
Excluding official transfers and project related imports	-11.2	-12.4	-13.3	-12.0	-10.7	-9.1	-9.0	-8.8
Import price index (2005 = 100)	113.7	106.1	116.8	50.0	50.1	80.1	33.3	83.8
Import volume (percent change)	14.3	7.3	-0.5	-193.0	50.1	80.1	85.8	83.8
REER (percent change)	13.9	...	...	...	...	...	...	...
Overall balance (percent of GDP)	-0.2	-3.2	-3.2	-4.2	-3.1	-2.3	-2.4	-3.5
Terms of trade (percent change)	-1.3	7.6	-3.8	-1.4	-0.1	-0.9	-1.0	-1.0
Nominal GDP (millions of U.S. dollars)	11,030.7	11,847.3	12,108.1	12,577.2	12,854.7	13,102.4	13,407.9	13,811.6

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

[1]The IMF has adopted the Malawi National Statistics Office (NSO)'s capital and financial account data following adoption of the NSO's current account data in 2019. Previously, the IMF's reported series was based on staff estimates. Consequently, the IMF's reported capital account balance increased from 3.8 percent of GDP to 11.7 percent of GDP in 2018 while financial account balance including net errors and omission decreased from 16.5 percent of GDP to 8.6 percent of GDP.

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

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

Table 5. Malawi: Selected Banking Soundness Indicators, 2019–21

Key ratios	Dec-19	2020				2021
		Q1	Q2	Q3	Q4	Q1
Capital Adequacy						
1. Regulatory Tier 1 capital to risk weighted assets	17.0	18.5	18.8	17.6	17.4	20
2. Total regulatory capital to risk weighted assets	21.0	22.2	22.0	20.6	20.8	23.6
3. Total capital to total assets[1]	16.4	16.0	16.0	13.5	13.1	14
Asset composition and quality						
1. Non-performing loans to gross loans and advances	6.3	5.8	6.6	6.2	6.3	8.3
2. Provisions to non-performing loans	38.6	35.6	35.6	41.2	32.9	25
3. Total loans and advances to total assets	33.2	31.7	31.7	33.0	31.2	30.8
4. Foreign currency loans to total loans and advances	20.9	35.4	35.4	14.7	14.7	12.9
Earnings and profitability						
1. Return on assets (ROA)	2.7	5.3	3.2	3.0	3.0	3.3
2. Return on equity (ROE)	20.5	41.9	23.6	197.4	22.8	24.5
3. Non-interest expenses to gross income	51.8	56.2	48.6	49.1	49.0	46.3
4. Interest margin to gross income	59.6	52.7	48.6	66.5	65.6	70.3
5. Non-interest income to revenue	33.6	34.9	34.9	33.5	34.4	29.7
6. Net interest income to assets	8.4	4.2	4.2	6.2	8.0	2.1
7. Personnel expenses to non-interest expenses	43.0	42.2	42.2	42.6	42.5	43.7
Liquidity						
1. Liquid assets to deposits and short-term liabilities	58.9	60.1	58.2	57.2	57.5	56.8
2. Total loans to total deposits	54.2	52.4	52.4	53.5	50.0	50
3. Liquid Assets to total assets	39.8	33.5	40.0	40.0	39.6	38.9
4. Foreign exchange liabilities to total liabilities	15.8	13.5	13.5	13.8	16.1	14.3

Source: Reserve Bank of Malawi.

[1] In the total capital to total assets series, total capital refers to regulatory capital.

Table 6. Malawi: Indicators of Capacity to Repay the Fund[1], 2021–34

(In millions of SDR, unless otherwise indicated)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Projected Payments based on Existing Drawings:														
(SDR millions)														
Principal	0.0	25.8	22.4	23.1	33.5	47.8	40.5	37.4	34.1	21.1	0.0	0.0	0.0	0.0
Charges and interest	0.00	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Projected Payments based on Prospective Drawings:														
(SDR millions)														
Principal	0	0	0	0	0	0	3.7	8.6	13.6	18.5	22.2	18.5	13.6	8.6
Charges and interest	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Projected Payments based on Existing and Prospective Drawings:														
SDR millions	0.00	25.88	22.44	23.18	33.53	47.91	44.24	46.12	47.70	39.69	22.28	18.58	13.64	8.70
US$ Millions	0.00	37.80	33.07	34.38	49.98	71.74	66.24	69.06	71.43	59.43	33.36	27.82	20.42	13.03
Percent of exports of goods and services	0.00	3.16	2.48	2.26	2.93	3.80	3.17	3.00	2.93	2.29	1.19	0.95	0.66	0.40
Percent of debt service	0.00	7.16	6.09	6.32	10.45	11.39	8.94	8.50	8.61	6.77	3.55	2.70	1.88	1.17
Percent of quota	0.00	18.65	16.17	16.70	24.16	34.52	31.87	33.23	34.37	28.60	16.05	13.39	9.83	6.27
Percent of gross official reserves	0.00	9.41	7.98	7.46	10.04	14.03	12.02	9.75	7.35	4.55	1.95	1.31	1.09	0.75
Percent of GDP	0.00	0.30	0.26	0.26	0.37	0.52	0.46	0.45	0.44	0.34	0.18	0.14	0.10	0.06
Projected Level of Credit Outstanding based on Existing and Prospective Drawings:														
SDR millions	285.6	259.8	237.5	214.3	180.9	133.0	92.6	55.2	21.1	0.0	0.0	0.0	0.0	0.0
US$ Millions	414.5	381.3	351.0	318.7	270.2	199.6	138.9	82.8	31.7	0.0	0.0	0.0	0.0	0.0
Percent of exports of goods and services	38.5	31.9	26.4	20.9	15.9	10.6	6.6	3.6	1.3	0.0	0.0	0.0	0.0	0.0
Percent of debt service	81.5	72.2	64.6	58.6	56.5	31.7	18.7	10.2	3.8	0.0	0.0	0.0	0.0	0.0
Percent of quota	205.8	187.2	171.1	154.4	130.3	95.9	66.7	39.7	15.2	0.0	0.0	0.0	0.0	0.0
Percent of gross official reserves	105.2	94.9	84.7	69.1	54.3	39.0	25.2	11.7	3.3	0.0	0.0	0.0	0.0	0.0
Percent of GDP	3.4	3.0	2.7	2.4	2.0	1.4	1.0	0.5	0.2	0.0	0.0	0.0	0.0	0.0
Memorandum items:														
Exports of goods and services (millions of U.S. dollars)	1,078	1,197	1,331	1,522	1,704	1,890	2,093	2,305	2,440	2,592	2,793	2,942	3,082	3,286
Debt service (millions of U.S. dollars)	508.4	528.1	543.5	543.9	478.5	629.7	740.8	812.5	829.7	878.1	940.1	1032.2	1087.5	1116.0
Quota (SDR millions)	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8
Gross official reserves (millions of U.S. dollars)	394	402	415	461	498	511	551	708	972	1,305	1,714	2,130	1,872	1,738
GDP (millions of U.S. dollars)	12,108	12,577	12,855	13,102	13,408	13,812	14,558	15,409	16,307	17,258	18,235	19,304	20,437	21,723

Source: IMF staff projections.

[1]Financing support from the IMF CCRT is recorded as a grant for debt relief.

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Annex I. External Stability Assessment

The external position in 2020 was substantially weaker than the level implied by medium-term fundamentals and desirable policies.

Overall Assessment: The external position in 2020 was substantially weaker than the level implied by medium-term fundamentals and desirable policies, after considering the impacts from COVID-19 pandemic and natural disaster adjustors.[1] The current account deficit expanded from 12.6 percent of GDP in 2019 to 13.6 percent in 2020, resulting mostly from a significant decline in exports whereas a slight import compression. For 2021, staff expects an only marginal improvement in the current account deficit, reflecting a slight recovery in exports although still far below from the pre-COVID level, along with imports remaining almost at the level of 2020. Gross reserves declined significantly, by close to US$200 million, to US$ 565.5 million at the end of 2020. It continued a declining trend during the first half of 2021. The adequacy of reserves level based on a model for credit constrained economies reveals 3.9 months of imports coverage. The CA model based REER assessment shows a large overvaluation, despite continued depreciation in most of months in 2020. Depreciation, at a very slow pace, continues in 2021. (Text Table 1).

Malawi: Model Estimates for 2020 (in percent of GDP)

	CA model	REER model
CA-Actual	**-13.6**	
Cyclical contributions (from model) (-)	0.2	
COVID-19 adjustor (+) 1/	-1.2	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-14.8**	
CA Norm (from model) 2/	**-7.6**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**-7.6**	
CA Gap	**-7.2**	
o/w Relative policy gap	1.9	
Elasticity	-0.28	
REER Gap (in percent)	**25.5**	**-0.1**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic balances (-0.85 percent of GDP) and on tourism (-0.31 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

1. **Current account deficits widened as tobacco exports stagnated**. The widening of the current account deficit in 2020 came mostly from an expansion of trade deficits, due to a significant decline in exports whereas a levelling-off of imports. Declines in exports reflect both a slowdown in goods trades due to the COVID-19 pandemic as well as a dragging impact from the U.S. ban on

[1] Additional adjustment to strip out transitory COVID-19 impacts, incorporated for 2020 ESA was -1.2 percent.

imports of Malawi's tobacco that was in effect between November 2019 and August 2020 (Text Figure 1).

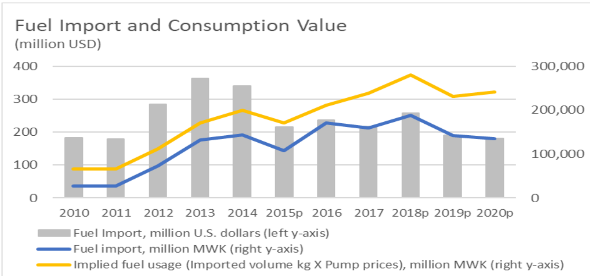
2. **On the imports side**, fuel (petroleum products, paraffin, diesel, coal) and fertilizers are the main goods of strategic imports, and historically they account for around 18 percent of total goods imports. Regarding fuel imports, the import volume has seen an uptick since 2015 (a year with a drought) and, after a slight decline in 2019, saw a largest increase (close to 350 million liters) in 2020. Increasing fuel imports reflects the government's energy strategy to meet increased electricity demand: however, the pace of fuel imports does not seem to align with a shift in energy supply mix. In addition, implied consumption is not consistent with the import values. The government expects a further increase in fuel imports as a shift from biomass to other biofuels accelerates.

3. **Malawi experienced droughts from 2012 to 2013, and between 2015 and 2018, affecting 1.9 million people during the time. In those years, flood episodes occurred in other parts of Malawi**. Imports value, as well as volume of fertilizers show a steady and significant increase since 2016, after a large drop from 2014 to 2015. The decline in import volume in these years, out of a drought, cast doubt on inventory of fertilizers (at the national level). The year 2020 saw a significantly large value and volume of imports, which might have to do with inventory pileup and/or subsidy related imports. Although the government foresees continuing of imports increase, the cost of imports needs deliver results such as an increase in agricultural production or an expansion of agricultural export diversity.

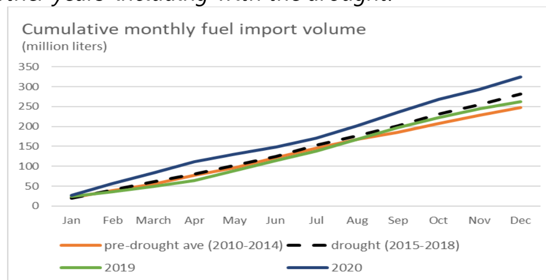
4. **Overall, a well-calibrated fiscal and external adjustment supported by a feasible financing mix will be necessary to address Malawi's macroeconomic imbalances.** Further fiscal consolidation to provide room for imports financing, as well as a gradual exit from taking open swap positions, more exchange rate adjustments, and the resumption of tobacco exports to the United States would be necessary to correct external sector imbalances. Given the level of external debt vulnerabilities, taking immediate and upfront actions to restore debt sustainability is also important.

Figure 1. Malawi: Strategic Imports of Fuel and Fertilizers

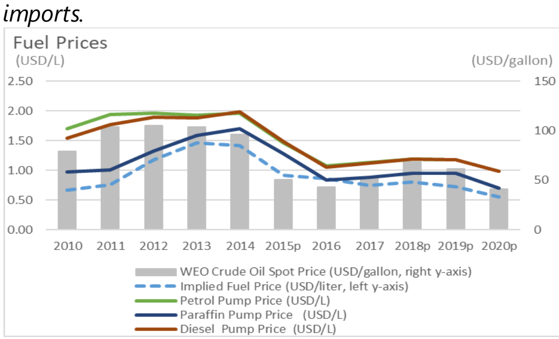
Fuel imports has been on a rise.



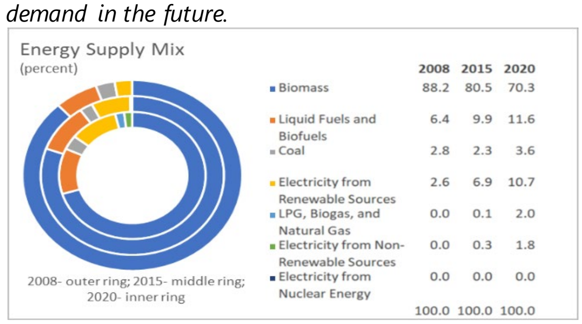
Volume of fuel imports in 2020 exceeded those of other years including with the drought.



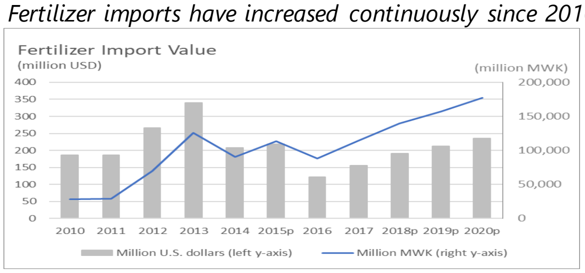
Oil and other commodity prices hit the historically low level in 2020 but are projected to recover that may weigh on imports.



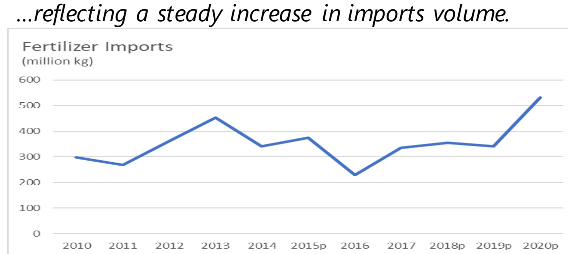
The projected energy supply mix shows increasing reliance on fuel—implying further increases in fuel demand in the future.



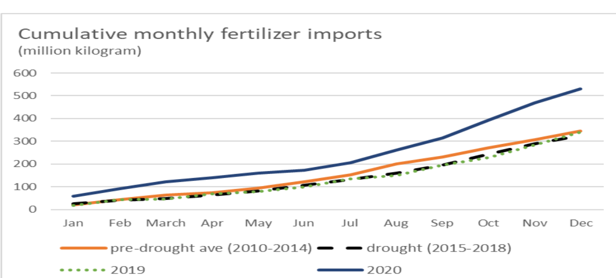
Fertilizer imports have increased continuously since 2016...



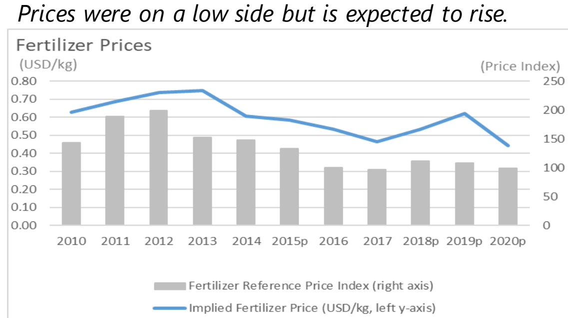
...reflecting a steady increase in imports volume.



The pace of imports accelerated in 2020.



Prices were on a low side but is expected to rise.



Source: Malawi Authorities (2021), Malawi National Energy Policy (2018), Staff Calculations.

Annex II. Risk Assessment Matrix[1]

(Scale – high, medium, or low)

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
		Global Risks	
Uncontrolled COVID-19 local outbreaks and subpar/volatile growth in affected countries.	High	**High.** Outbreaks in slow-to-vaccinate countries force new lockdowns. For many Low-Income Countries, policy response to cushion the economic impact is constrained by lack of policy space, with some market access countries facing additional financial tightening as a reassessment of growth prospects triggers capital outflows, depreciations, and debt defaults.	Limit the damage by cushioning income losses for people and firms, including by increasing spending on health and social protection. Follow global public health guidance, including to find, isolate, test and care for cases, and trace and quarantine their contacts. If required, use additional periods of stringent containment measures to build health system capacity.
Global resurgence of the COVID-19 pandemic.	Medium	**High**. Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.	A faster containment of the pandemic following an effective rollout of vaccines domestically and globally.
Widespread social discontent and political instability.	Medium	**Low**. Social tensions erupt as a withdrawal of pandemic-related policy support results in unemployment and, amid increasing prices of essentials, hurts vulnerable groups (often exacerbating pre-existing inequities).	Encourage the authorities and development partners to increase social priority spending to build the resiliency of vulnerable populations. Undertake promised reforms in a transparent and equitable manner. Strengthen governance measures.
Rising commodity prices amid bouts of volatility.	Medium	**Medium**. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices.	Tighten monetary policy, increase exchange rate flexibility, strengthen FX reserve buffer, gradually adjust energy and fertilizers prices to reflect market prices, apply the automatic fuel price adjustment mechanism and replenish the fuel price stabilization to ensure adequate energy supplies and contain additional fiscal cost/contingent liabilities.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood 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. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia.	Medium	**High.** A fast recovery in demand (supported by excess private savings and stimulus policies), combined with COVID-19 related supply constraints, leads to sustained above-target inflation readings and a de-anchoring of expectations. The Fed reacts by signaling a need to tighten earlier than expected. The resulting repositioning by market participants leads to a front-loaded tightening of financial conditions and higher risk premia, including for credit, equities, and emerging and frontier market currencies	Upfront action to address debt sustainability and avoiding external non-concessional borrowing. Resorting to debt management strategy which relies on grants and highly concessional loans.
Regional and Domestic Risks			
Excessive external borrowing at non-concessional terms with a possibility of a sudden stop.	High	**High**. Borrowing to finance the budget, including implementing an overly ambitious capital investment program, especially, if financed with non-concessional external loans would further heighten debt vulnerability. Given the high dependency, a sudden stop can result in an abrupt forced adjustment.	Elaborate a prudent and well appraised public investment program, secure concessional financing, and assess the impact of borrowing on debt sustainability. Commit to a credible fiscal program that brings Malawi's debt distress to the moderate level.
Governance weaknesses.	High	**High**. Overly ambitious capital investment beyond the country's absorptive capacity and weak institutions can result in a misuse of public resources, resulting in a rise in debt with little impact on growth. Conflicting signals on policy intentions can also adversely affect market participants' confidence.	Strengthen institutions to address weaknesses in governance, roll out of IFMIS, supported by the authorities' credible reforms. Strengthen public investment management (PIM).
Delayed PFM reforms and lack of expenditure control.	Medium	**High**. Uneven progress of PFM reform and deficient expenditure control undermine confidence in budgetary processes and efforts to effectively and transparently manage expenditure. Re-emergence of arrears resulting from delays in PFM reforms will add to debt distress.	Accelerate implementation of PFM reform programs, strengthen corruption control, and communicate regularly and transparently
Fiscal dominance resulting in deficient conduct of monetary policy.	Medium	**High**. Inability to keep reserve money growth in line with nominal GDP growth can result in pressure on the exchange rate, the RBM's foreign exchange reserves, and inflation. Conflicting signals on policy intentions can also adversely affect market participants' confidence.	Strengthen RBM independence. Continue adopting clear and effective monetary operational framework.
Higher frequency and severity of natural disasters related to climate change.	Medium	**High**. Frequent natural disasters can cause severe economic damage, impose additional burden on public debt and humanitarian cost. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility.	Build economic resilience, through human capital investment, and addressing deforestation.

Annex III. Implementation of the 2018 Article IV Recommendations

Key Recommendations	Implementation
Restore macroeconomic stability	Political uncertainty due to the prolonged election process, legacy debt burden, and the COVID-19 shock resulted in persistent macroeconomic imbalances and further deterioration in macroeconomic stability.
Strengthen fiscal position to preserve debt sustainability	Primary deficit increased from 1.9 percent of GDP in FY2018/19 to 2.7 percent of GDP in FY 2019/20 as the authorities undertook necessary measures to face the COVID pandemic and support the vulnerable. Expenditure has expanded substantially partly due to elections and the pandemic, while domestic revenue mobilization efforts showed little results.
Improve the quality of public spending	The authorities undertook an audit of PSIP database and a pilot audit of two capital projects. Efforts continue to reprioritize expenditure, focusing on critical public spending with the highest return on growth and social dividend.
Strengthen governance and transparency	The new administration is forcefully fighting governance weaknesses. The National Audit Office (NAO) conducted an audit report and identified irregularities and mismanagement in the procurement and contract awarded process of COVID-19- related public funds. The current administration has taken administrative actions against the civil servants allegedly involved.
Greater exchange rate flexibility	The exchange rate has been fairly stable which resulted in overvaluation by about 30 percent and the depletion of reserves. Obstacles to FX market development hamper deepening the foreign exchange market and restrict exchange rate movement.
Safeguard financial sector stability	The banking system remained stable and well-capitalized. Non-performing loans remained stable. IFRS9 requirements are in place.

Annex IV. Capacity Development Strategy

Context

1. **President Chakwera was elected and took office in June 2020.** In January 2021, the new authorities launched their long-term development vision, Malawi 2063, which articulates their commitment to implement policies to entrench macroeconomic stability and help to achieve higher, more inclusive, and durable growth by investing in human capital, building resilience to climate change while preserving debt sustainability. The authorities aim to restore macroeconomic stability through a reform agenda focused on tackling governance weaknesses and strengthening PFM and cash management.

2. **Past TA and training from the IMF supported the authorities' reforms and helped to build capacity.** PFM TA to the Ministry of Finance has enabled the authorities to commence reforms in the critical areas of bank reconciliation, payment efficiency, in-year and year-end financial reporting, budgeting, expenditure control, cash management, SOE oversight, public investment management, preparing for rolling out the new IFMIS and management of fiscal risks. However, more effort is needed to make progress on the implementation the new IFMIS and cash management and to improve the quality, analysis, use and publication of available information. TA to the Reserve Bank of Malawi on financial sector supervision and FPAS TA on forecasting and inflation and monetary policy analysis to support modernizing its monetary policy framework have gained traction and yielded results. Lastly, on statistics, TA helped Malawi to start progress towards improving the quality and regular reporting of data on national accounts, monetary, BOP, government finance and financial statistics.

CD Strategy and Priorities

3. **Going forward, the CD strategy for Malawi should focus on supporting the proposed program and the authorities' objectives outlined in Malawi 2063 Vision**. Specifically, in the **PFM** area, the strategy will build upon recent PFM reform efforts to ensure that expected gains in budget preparation, cash management, commitment control, banking arrangements, accountability and payment efficiency are delivered from the government's investment in the new IFMIS. It will be important that lessons learned from the new IFMIS piloting phase launched in July 2020 are applied to ensure that the full IFMIS rollout meets efficiency, security, expenditure control, accountability, and sustainability objectives. On the **revenue** side, TA will support the authorities' renewed energy to implement tax policy and revenue administration reforms, focusing on the quantification and implementation of the new Domestic Resource Mobilization (DRM) strategy starting in the FY2021/22. Together, efforts to improve PFM and DRM will be critical for strengthening the fiscal path, recovery from the impact of the COVID-19 pandemic and managing the fiscal risks. TA to the Reserve Bank of Malawi (RBM) will be tailored to deepen **interbank foreign exchange market** and to improve **foreign exchange reserve management** given the need to rebuild official foreign exchange reserves. Improving the timeliness, quality and coverage of **statistics** will remain critical to supporting sound policymaking and monitoring performance under the proposed ECF. The focus will be on monetary and financial statistics in standard reporting format, improving the compilation

methodologies and metadata for national accounts, establishing a GDP revision policy, improving BOP statistics, broadening the coverage of fiscal statistics to the public sector, and expanding sectoral and instrument coverage of public sector debt statistics. The CD strategy will also support TA that strengthens the capacity of the National Audit Office. This strategy is closely aligned with the previous CSN developed in September 2020. It is expected that FAD, LEG, MCM, and STA will continue to provide a significant amount of TA, which would continue to be delivered to a large extent by AFRITAC East and the resident FAD advisors. The engagement strategy will consider varying absorption and implementation of TA across institutions and work streams, working closely with other development partners.

Key Overall CD Priorities Going Forward

Priorities	**Objectives**	**Challenges**
Public Finance Management	• Implementation of the new IFMIS as an enabler for key PFM reforms in budget preparation, expenditure control, bank reconciliation, cash management, payment efficiency and accountability. • Completion of the verification of arrears covering the period July 1, 2017-June 30, 2020 certified by the Auditor General to support the strategy of arrears clearance. • Strengthen the management of fiscal risks and the oversight of state-owned enterprises. • Improve public investment management systems.	Steps to stabilize and optimize the new IFMIS before the full roll out to all MDAs have been delayed and could potentially delay the full launch of the new IFMIS. Technical issues surfacing in the pilot phase should be addressed through a security audit of the new IFMIS and investing in change management. This calls for additional support and closer coordination among DPs.
Tax Policy and Revenue Administration	Support the authorities in quantifying and implementing the DRM strategy; assess (and improve) ITAS implementation, diagnose issues in taxation of the informal sector and prepare compliance strategy for micro and small taxpayers, and review and redesign customs clearing controls and procedures, improve VAT compliance and promoting integrity within MRA.	The COVID-19 pandemic has slowed down the finalization of the DRM strategy. DRM implementation can only begin in the fiscal year (FY2021/22).
Statistics	Continue improving compilation and dissemination of statistics and developing staff capacity, with a focus on the national accounts, BOP, and monetary survey in SRF. Other priority areas include updating and improving the consumer price index and updating the periodic benchmark estimates for better quality	

	estimates of national accounts statistics, expanding coverage of fiscal and public debt statistics to the entire public sector and disseminate high frequency fiscal and debt data.	
FX Reserve management	Deepen interbank foreign exchange market and improve foreign exchange reserve management.	

Authorities' Views

The authorities are in broad agreement with staff on CD priorities. The authorities expressed interest in priority arears related to Malawi's Domestic Revenue Mobilization Strategy (DRMS), which include financial modelling to forecast revenue from the extractive sector; specifically forecasting revenues for the two prospective mining investment ventures and the ongoing investment in gold mining. In addition, the authorities are interest in capacity development focused on tax expenditure reporting to inform the Ministry of Finance implementation of the incentives scheme and exemptions.

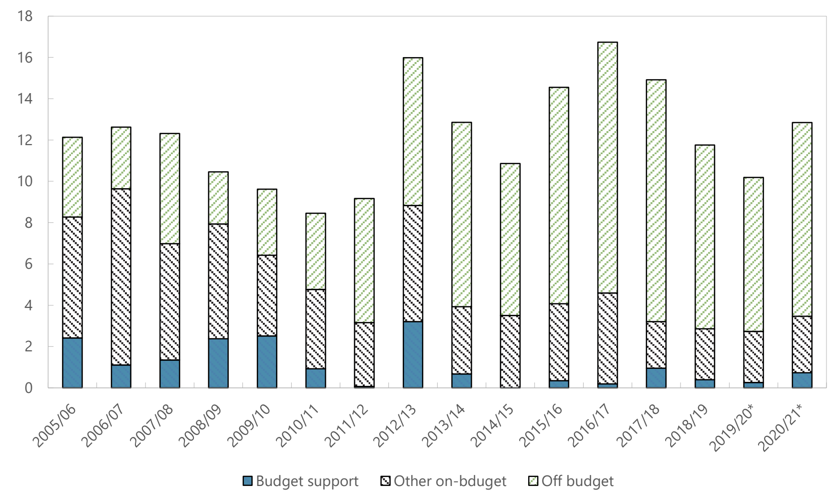
Annex V. Country Engagement Strategy

This forward-looking engagement strategy takes stock of fragilities faced by Malawi; provides an assessment of the IMF's engagement with the country since the 2013 Cashgate scandal—including successive ECF arrangements; and lays out priorities for IMF engagement. The strategy anchors on a possible successor ECF arrangement on restoring macroeconomic imbalances and aligned with the authorities' long-term development plan (Malawi Vision 2063).

1. **Malawi has been supported by the international community including the IMF over the past decades and yet the exit from fragility is not in sight**. The international community continued to support Malawi through budget and off-budget support, and project financing: the total official development assistance (ODA) is estimated to have averaged US$1.1 billion or 12 percent of GDP during 2005-20. Sustaining Malawi's growth in the past decade, however, has been challenging, partly due to frequent natural disasters (¶13). As a result, GDP growth barely kept up with population growth, leaving per capita income stagnant. Moreover, the exit from fragility is not in sight as the debt burden is projected to increase and crowd out private sector investment and to hinder medium-term economic prospects.

Text Figure 1. Malawi: Official Development Assistance, 2005-21

Malawi has been supported by the development partners. However, sustaining growth in the past decade has been challenging due to frequent natural disasters.



Sources: OECD database on Official Development Assistance; Ministry of Finance; and IMF Staff estimates.

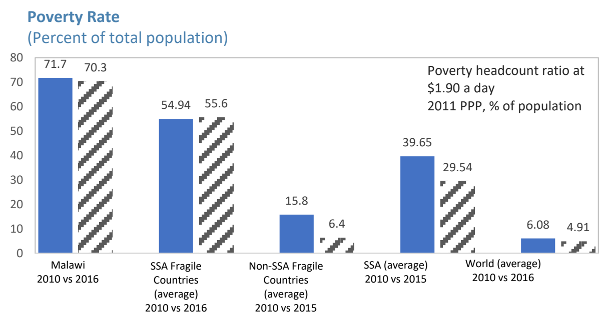
2. **Malawi suffers from social and institutional fragility.**[1] Malawi has not experienced significant conflict since 1993 but has the 3rd lowest per capita GDP in sub-Saharan Africa (SSA) (Text Figure 2). The incidence of poverty and food insecurity in Malawi is amongst the highest in the world; human development indicators rank amongst the lowest—especially gender-based violence, early marriages, and maternal health; and less than 20 percent of Sustainable Development Goals

[1] Malawi is classified as a fragile state by the IMF, where a country is considered fragile based on having either (i) weak institutional capacity measured by the World Bank Policy and Institutional Assessment (CPIA) score averaging 3.2 or lower (Malawi's average is 3.2); and/or (ii) experience of conflict signaled by the presence of a peace-keeping or peace-building operation in the most recent three-year period (Malawi has had neither). According to the World Bank's definition, Malawi is not a fragile state as the CPIA threshold applied by the World Bank is an average score of 3.0 or lower (https://www.worldbank.org/en/topic/fragilityconflictviolence/brief/harmonized-list-of-fragile-situations).

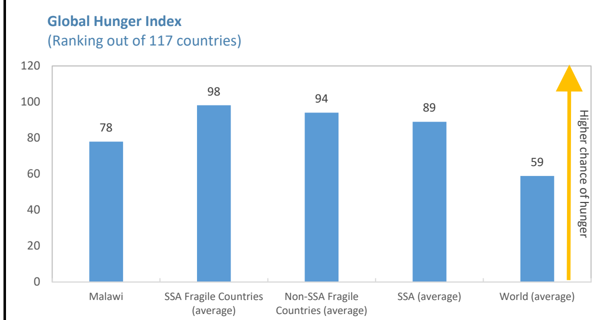
(SDGs) have been met. These challenges are compounded by weak governance, and poor quality of public administration combined with limited fiscal space and high public debt which weigh on the government's ability to effectively implement policies; especially those targeted at improving incomes and living standards across the population.

Text Figure 2. Malawi: Social Indicators, 2010-2020

Malawi has the 3rd highest poverty head count ratio in the world.



...and ranks 78th (out of 117 countries) in the Global Hunger Index.

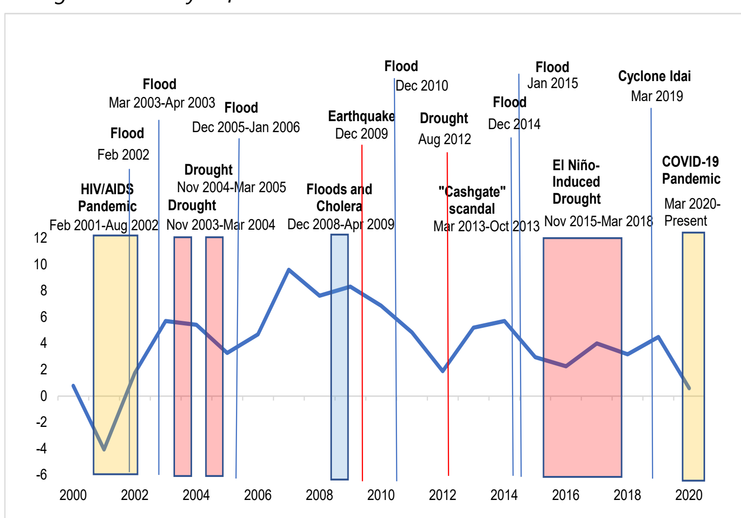


Source: World Bank database, Global Hunger Index, and Human Development Index.

3. **External shocks—including the current COVID-19 pandemic and frequent climate change shocks—risk derailing macroeconomic stability, efforts to boost growth, and institutions building**. Over the past two decades, Malawi has had at least one climate shock every year (Text Figure 3). These shocks are often severe. For example, the El Niño-induced drought, resulted in nearly 40 percent of the population becoming food insecure (almost half of whom were children). Major droughts, floods, and now the fallout from the COVID-19 pandemic weigh heavily on economic activity and incomes. With each shock, tax revenues decline at a time when fiscal spending needs to mitigate the impact of the shock are high; inflationary pressures rise, particularly when corps are destroyed; international reserves pressures rise (even when exchange rate flexibility is applied); and the capacity to implement reforms is jeopardized—especially during the COVID-19 pandemic.

Text Figure 3. Malawi: Extreme Weather Events and Growth, 2000-20

Growth is highly vulnerable to extreme weather events including floods and droughts caused by deforestation.



Source: EM-DAT database; and IMF staff estimates.

Sources and Consequences of Fragility

4. **Malawi's fragility stems primarily from several critical factors which present challenges for sustaining inclusive growth and improving social indicators**.[2] These include:

- **Inadequate investment in human capital development, especially education, to support inclusive and resilient growth.** Poverty and inequality remain high in Malawi (¶1 above and Text Figure 1) which is further complicated by challenges related to raising educational attainment in Malawi. These include low school attendance rate, high repetition, and drop-out rates, especially for girls, partly due to early child marriage. The government has stepped up efforts to eliminate child marriage—affecting 42 percent of girls—and violence against women and children through changes in the legal framework and government intervention programs supported by development partners. However, it takes time to change behavioral patterns (Annex VI).

- **Dependence on rain-fed agriculture and lack of crop diversification.** Two thirds of the population are employed in agriculture (primarily maize farming), contributing to about 30 percent of GDP. Each weather-related shock risks failure of major staple crops such as maize, contributing directly to rural poverty and indirectly to urban poverty—where food shortages result in food price inflation across the country while incomes decline in manufacturing and retail trade sectors that are closely linked to agriculture. Crop diversification and erosion protection are critical to boosting agricultural productivity. Malawi's agricultural exports—tobacco, tea, and sugar (about 80 percent of Malawi's agricultural exports)—are slightly more resilient to weather shocks than maize but they are vulnerable to shocks in global prices (Annex I).

- **Insufficient infrastructure, especially in electricity, irrigation, and transport to support economic activity.** Frequent and lengthy electricity shortages disrupt economic activity. Malawi's dependence on hydroelectricity is a root cause which calls for diversifying the energy mix towards solar, and wind power (Annex VII). In addition, poor coverage of irrigation systems to support the agriculture sector, and inadequate water sources creates shortages for households. Moreover, limited transport infrastructure and trade logistics pose significant challenges for this landlocked country, including high transport costs weighing on farmers and businesses. Maintenance of poorly constructed and heavily used roads crowds out government spending on other infrastructure.

[2] IMF Country Report 18/116 present the analysis that led to the derivation of these factors. Detailed policy measures to address these challenges are elaborated in the National Resilience Strategy (NRS) 2018-30.

Annex VI. Raising Educational Attainment in Malawi

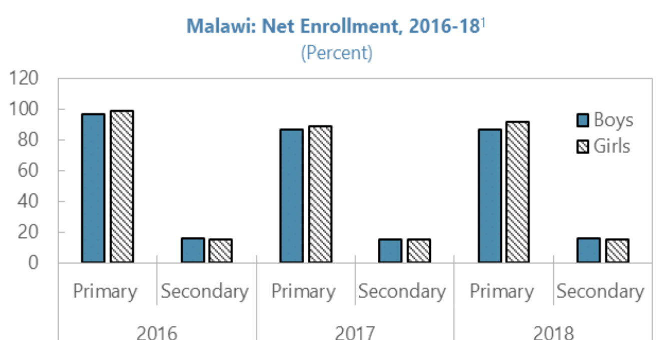
Malawi has an abundant youth population. Increasing quality and quantity of education in Malawi will turn the growing generation into a key driver to achieve sustained and inclusive long run growth.

1. **Human capital is critical for boosting inclusive growth**. At an individual level, education raises productivity, diversifies sources of income, and, in turn, earnings potential, resilience to shocks, and standards of living—reducing inequalities. From a macroeconomic perspective, education improves the knowledge and skills of workers, which increases labor productivity, global competitiveness, and ultimately, long-run economic growth.

2. **In Malawi, school attendance rates drop sharply with age.** Enrollment drops between primary and secondary school. Net enrollment rate is 90 percent for primary school but merely 15 percent for secondary school—the large gap in primary and secondary enrollment rates is due to low primary completion rates (52 percent) and low transition rates (38 percent) to secondary school. (Text Figure 1).

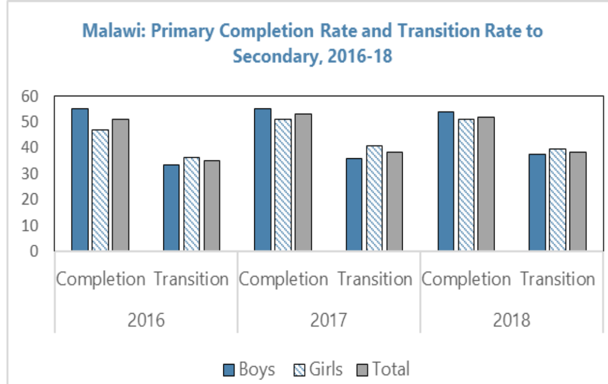
Text Figure 1. Malawi: Selective Indicators of Education, 2016-18

Net Enrollment is as high as 90% for primary school but drops to 15% for secondary school.



[1] Net enrollment is the number of pupils enrolled in primary (or secondary) education as a percentage of the children of official school age population.

However, primary school completion rates are barely over 50 percent and secondary school transition rates are below 40 percent.



Source: Malawi Education Management Information System (EMIS).

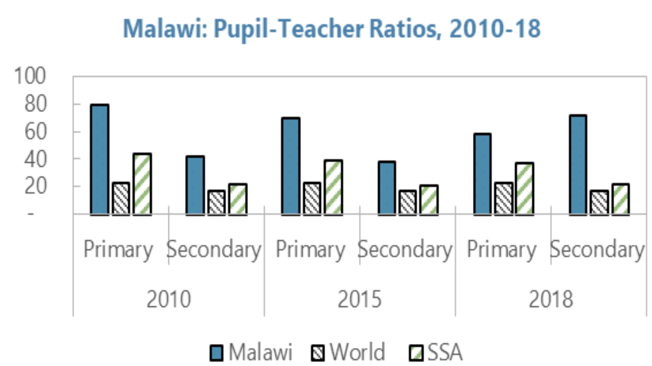
3. **Malawi suffers from high repetition rate and drop-out rate.** Around 90 percent of children at primary school age attend primary school standard 1 (the first year of school). However due to high repetition rate (33 percent for std1) and drop-out rate, by the time they reach standard 5 (representing completion of the first half of primary school), the probability of attending the next standard declines to about 50 percent of standard 1. Anecdotal evidence suggests the reasons

behind this are a combination of insufficient teacher resources dedicated to those children who need more attention and poor attendance—notably, high repetition rates at earlier ages may demotivate children from attending school (Text Figure 1).

4. **Malawi's pupil-teacher ratio is high and is anticipated to worsen to 80 percent in secondary school if number of teachers remains the same** (Text Figure 2). Malawi's pupil-teacher ratio is twice higher than that of world average for primary school and four times higher than that of world average for secondary school. The pupil teacher ratio has improved somewhat from 2010 to 2018 for primary school but it has worsened for secondary school since 2015. Improving quality of teaching could have synergistic effect by cutting repetition and drop-out rates and reducing pupil teacher ratio in primary school, leading to positive spillover to secondary school attendance rate.

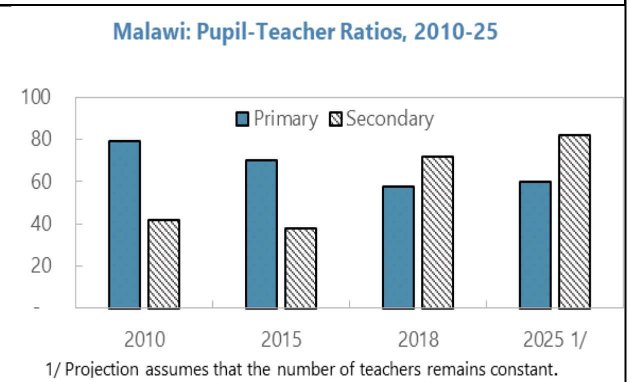
Text Figure 2. Malawi: Pupil-Teacher Ratios, 2010-18

Malawi's pupil-teacher ratios fall behind that of world and SSA. For secondary school, it has worsened in past few years.



Source: United Nations (2010-18). Human Development Index.

By 2025, Malawi's pupil-teacher ratios are expected to worsen for secondary school and stabilize at 2018 level for primary school if number of teachers remain constant.

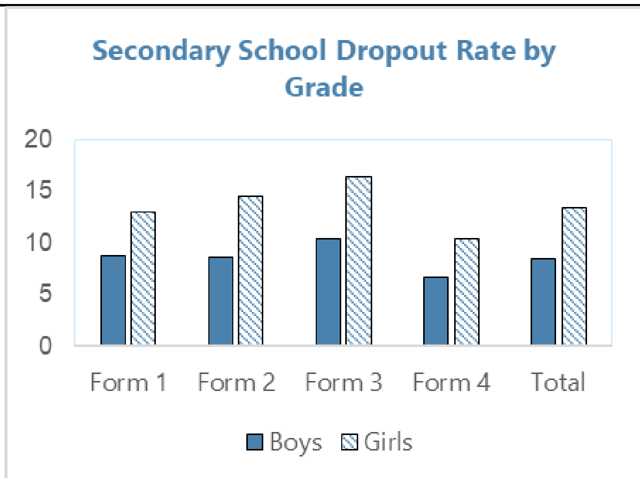


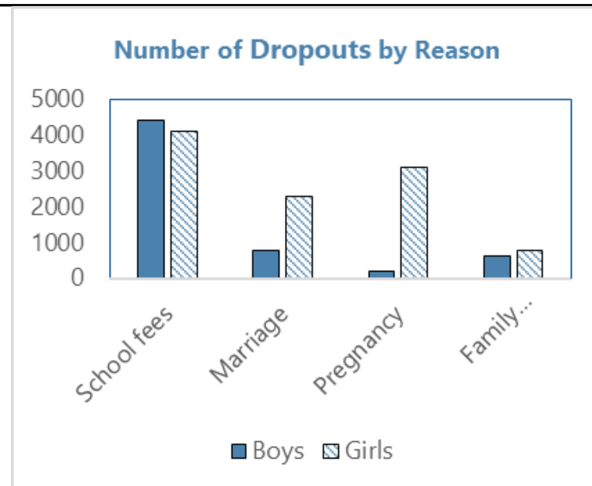
Source: United Nations (2010-18). Human Development Index; and IMF staff projections.

5. **In secondary school, the dropout rate for girls is more than double that of boys due to marriage and pregnancy**. Girls fare better than boys in primary school but then dropout before reaching secondary school. The lack of financial capacity (or wealth), especially to pay school fees was reported as the main reason for dropping out both for boys and girls. Marriage (usually decided by the father) and pregnancy were the next most important factors for girls—3 times more girls than boys indicate marriage as the reason for dropping out and 15 times more girls indicate pregnancy, especially for secondary school attendance. These factors along with family responsibilities also played a role, but for boys much less so.

Text Figure 3. Malawi: Dropouts by grade and reason, 2018

Secondary drop-out rate is much higher for girls.





Source: Malawi Education Management Information System (EMIS).

Source: Malawi Fourth integrated Household Survey 2016-17.

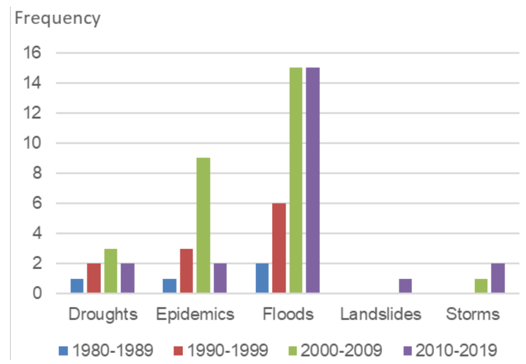
6. **Recent household survey shows that income and wealth of households critically affect school attendance, highlighting the importance of the affordability of education.** Empirical analysis using the Fourth Integrated Household Survey shows that income (proxied by consumption, access to credit) and wealth (proxied by homeownership and the education level of parents) are critical determinants of school attendance; for example, the father's education level which is a good proxy of household income and asset, is the strongest predictor for both primary and secondary school attendance. In this regard, the government's elimination of school fees is a step in the right direction. Maintaining positive per capita income growth at the macroeconomic level, supporting poorer families for ancillary costs (e.g., uniforms, books), expanding the social cash transfer system would also be important.

Annex VII. Fostering Climate Change Resilience and Inclusive Growth

Climate change impedes Malawi's sustained growth. Cost-effective investment in alternative energy sources to fuelwoods and human capital is critical in promoting resilience to climate-related shocks and inclusive growth.

1. **Malawi is vulnerable to increasingly frequent and unpredictable climate-induced natural disasters, such as droughts, floods, and extreme storms**. Between 1980 and 2020, Malawi experienced eight episodes of droughts, leaving a dark history of hunger, food insecurity, and loss of lives. Floods are also increasing with 30 episodes in the past two decades. Epidemics, often associated with storms and floods, also rose in the 2000s but subsided in the 2010s. In 2019, heavy rainfall in the Northern region triggered a deadly landslide.

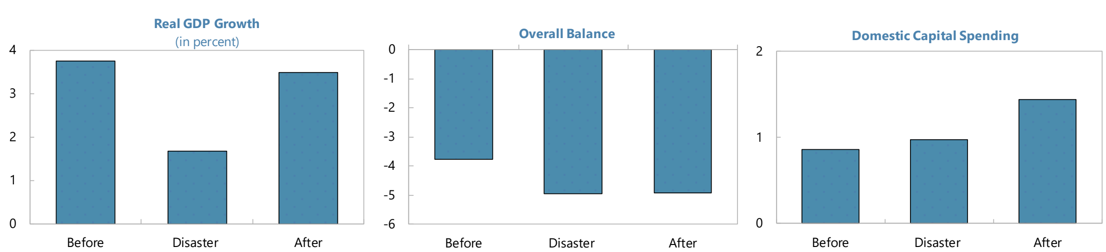
Text Figure 1. Frequency of Natural Disasters



Sources: EM-DAT; and IMF staff calculations.

Text Figure 2. Real GDP Growth, Fiscal Balance, and Public Capital Spending Before and After Natural Disaster

(in percent of GDP unless otherwise indicated)



Source: EM-DAT: The Emergency Events Database. Background paper "Malawi: Building Resilience to Climate Change" By M. Farahbaksh with inputs from F. Gwenhamo, E. Endengle, A. Lagerborg, E. Mensah, M. Wang, J. Yao, and G. Zinabou.

2. **Natural disasters have lasting impact on growth.** An event study finds that real GDP growth does not return to the pre-disaster rate despite increases in domestic capital spending (Text Figure 2).[1] Droughts and severe precipitation, hurt the economy by ravaging both physical and human capital, depressing productivity even in the medium-term. Agriculture households are especially hard hit from income loss, deterioration of farmland, destruction of household property,

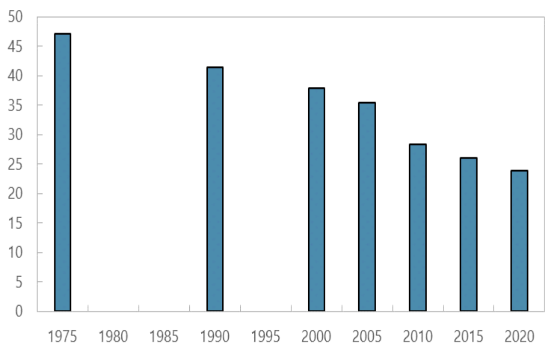
[1] The event study considers natural disasters that results in damage and losses of at least 0.5 percent of GDP. The before and after episodes are calculated using the two-year average value relative to the occurrence of the event.

and food insecurity. Flooding from extreme precipitation may also trigger an epidemic, such as cholera or malaria, through contamination of water supply and stagnant water that serves as a breeding ground for disease harboring mosquitos. Although rebuilding efforts usher economic recovery, fiscal responses stretch government resources, highlighting the macro-criticality of climate change in Malawi.

Malawi: Energy Mix, 1975-2009

Text Figure 3. Malawi: Forest, 1975-2020

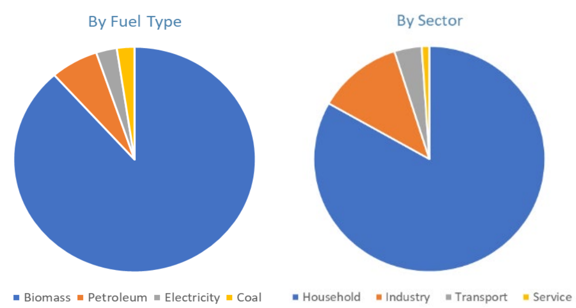
(Percent of total land use)



Source: FAO; and staff calculations.

Text Figure 4. Malawi: Energy Demand, 2009

(Percent of Total Energy Demand)

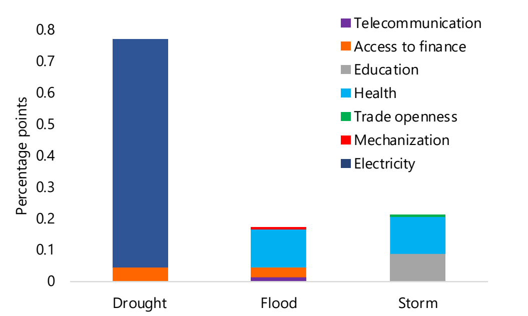


Source: Malawi authorities; Mauambeta, D. Chitedze, R. Mumba, S. Gama. 2010. "Status of Forests and Tree Management in Malawi" Working Paper. Coordination Union for Rehabilitation of the Environment; and staff calculations.

3. **Malawi has a long history of reforestation efforts dating back to 1920s and yet has had little success for various reasons.** Deforestation compounds the effect of climate change by diminishing natural protection to floods and landslides, and yet deforestation continues in Malawi (Text Figure 3) for a number of reasons. On the demand side, fuelwood continues to be the primary energy source used by households and the tobacco industry (Text Figure 4). Forest thinning is also aggravated by agriculture land clearing and forest fires. On the supply side, reforestation efforts of the government and international organizations have failed for a number of reasons (the Coordination Union for Rehabilitation of the Environment, 2010; Walker, 2004): (i) lack of sustained

Text Figure 5. Reduction in Impact of Disasters on Per Capita Annual Medium-Term Growth if Malawi's Structural Factors Are Improved to the Emerging and Developing Economy Average

(in percentage points)



Sources: Sources: World Bank, World Development Indicators; and IMF 2020. Background paper "Malawi: Building Resilience to Climate Change" By M. Farahbaksh with inputs from F. Gwenhamo, E. Endengle, A. Lagerborg, E. Mensah, M. Wang, J. Yao, and G. Zinabou.

political support, (ii) lack of funding, (iii) facilitation of illegal timber, allocation of logging plots, production and trafficking of charcoal, (iv) lack of low-cost alternative energy sources to fuelwoods, and (v) lack of support by farmers who need to prioritize food security and other valuable resources such as, fruit, timber, fiber, and medicine.

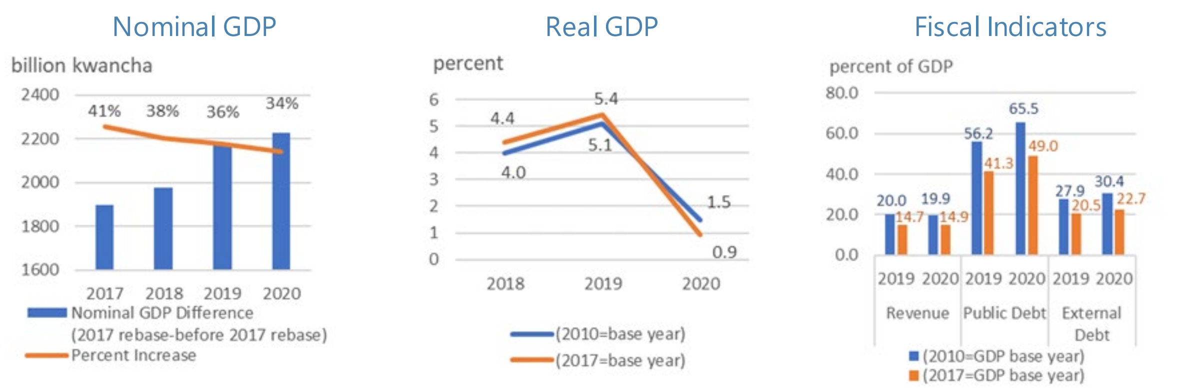
4. **Cost-effective investment in alternative energy sources to fuelwoods and human capital is critical in promoting resilience to climate-related shocks and inclusive growth**. Promoting alternative energy sources is important but it needs to be sustainable and cost effective given the fiscal situation. Alternative energy sources need to move away from firewood and charcoal— which aggravates deforestation, land degradation, and vulnerability to floods, landslides leading to food insecurity— and towards sustainable power generation mix, guided by Malawi Renewable Energy Strategy (2017). Education is also shown to alleviate the extent per capita income would decline during storms (Text Figure 5), as it can support the population through income diversification toward off-farm agriculture activities and non-agriculture sources. A more conscious approach to population growth through education can also ease food security concerns and support conservation efforts. Finally, education can increase effectiveness of early warnings thereby improving disaster preparedness (Annex VI).)

Annex VIII. National Accounts Rebasing

In October 2020, the National Statistics Office (NSO) of Malawi completed and published the 2017 rebased Gross Domestic Product (GDP) using the production approach. This was supported by two TA missions conducted in November 2019 and July 2020. In December 2020 and January 2021, two IMF follow-up TA missions assisted the NSO to compile GDP by expenditure, considering the newly rebased GDP by production. The TA missions were unable to fully assess the quality of the recently rebased estimates, and a follow-up mission is planned in November 2021. Moving forward, the TA mission recommendations included: improving data sources; reconciling GDP by production and by expenditure and introducing revision policy in line with international standards.

1. **As a result of the 2017 GDP rebasing, Malawi nominal GDP level for 2017 increased by 38.4 percent, bringing revenue-to-GDP, public and external debt-to-GDP ratios down to 14.9 percent, 49 percent and 22.7 percent, respectively**. Malawi updated the base year from 2010 to 2017 for computing national accounts constant price estimates. The rebased GDP expands the coverage of the National Accounts and draws upon improved data sources. The coverage expanded with the use of the 2016/17 Census of Economic Activities (CEA), which had been conducted for the first time in Malawi. Other data sources include the 2018 Population and Housing Census (PHC) and the 2016/17 Integrated Household Budget Survey (IHS), the 2016 Survey of Non-Profit Institutions Serving Households and administrative sources. (Text Figure 1).

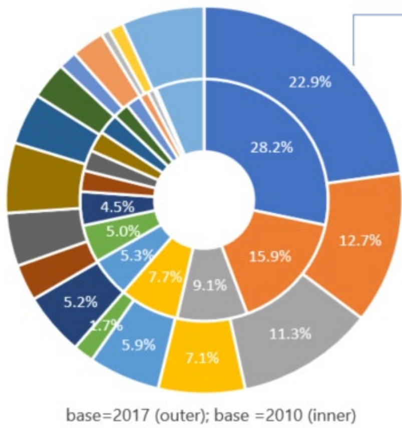
Text Figure 1. GDP Rebasing: Shift in Key Indicators



Source: Malawian authorities; and IMF staff calculations.

2. **The GDP rebasing altered the compositional shares of industries in GDP away from traditional industries**. Under the 2017 rebased GDP, the shares of agriculture, forestry and fishing, wholesale and retail trade, and real estate industries have decreased by 8.4 percentage points. Among the seven industries that comprise 75 percent of Malawi's GDP, the shares of manufacturing, financial and insurance activities, and information and communication, increased by 3.5 percentage points (Text Figure 2).

Text Figure 2. Compositional Share of GDP, 2017



Industries	(a) GDP Share 2010 Base	(b) GDP Share 2017 Base	(b)-(a)
A Agriculture, forestry and fishing	28.2%	22.9%	-5.3%
G Wholesale and retail trade; repair of motor vehicles and motorcycles	15.9%	12.7%	-3.2%
C Manufacturing	9.1%	11.3%	2.2%
L Real estate activities	7.7%	7.1%	-0.6%
K Financial and insurance activities	5.3%	5.9%	0.6%
R+S+T Arts, entertainment and recreation; Other service activities; Activities of households as employers	5.0%	1.7%	-3.3%
J Information and communication	4.5%	5.2%	0.7%
F Construction	2.8%	3.1%	0.2%
H Transportation and storage	2.7%	4.5%	1.7%
Q Human health and social work activities	2.7%	5.9%	3.2%
P Education	2.7%	4.3%	1.6%
O Public administration and defence; compulsory social security	2.1%	3.1%	1.0%
I Accommodation and food service activities	2.0%	1.5%	-0.4%
D+E Electricity, gas, steam and air conditioning supply; Water supply	1.2%	2.7%	1.5%
B Mining and quarrying	0.9%	0.7%	-0.2%
M+N Professional, scientific and technical activities; Administrative and support service activities	0.3%	1.2%	0.9%
Sum of All Industries value added	93.7%	93.2%	-0.5%
Taxes less Subsidies on products	6.3%	6.8%	0.5%
GDP at market prices	**100.0%**	**100.0%**	

Source: Malawi authorities and IMF staff calculations.

3. **Rebased GDP by production and by expenditure has a discrepancy of around 14 percent, highlighting the importance of reconciliation of the two measures**. Estimates for the 2017 rebased GDP are MK 6.5 billion by production approach and around MK 5.6 billion by expenditure approach. The TA mission in January 2021 found that the value added in most activities is overestimated after comparing between the 2017 rebased GDP by production and the CEA 2017 estimates.

4. **To ensure reconciliation between the production and expenditure approaches of the 2017 GDP rebasing and in line with best practices, the TA mission recommended the following**:

- **Data sources improvement.** (i) Obtain data sources for GDP estimates after 2017, particularly from annual ad-hoc small-scale sample surveys and administrative sources. Data from CEA 2017 and IHS 2016/17 are limited after 2017. (ii) Conduct a household survey to estimate own-account construction value. This estimate is missing from the newly rebased GDP by production and expenditure and is expected to impact the GDP level due to its large share. (iii) Obtain and use tax data from the Malawi Revenue Authority (MRA) as the main source of information on economic units in estimating annual GDP series.

- **Reconciliation of the GDP estimate using the production and expenditure sides.** The TA mission recommended to the NSO to finalize the GDP by expenditure and revise the GDP by production estimates, thereby narrowing the gap between the two GDP measures.

- **Revision analysis and announcement.** In line with international best practices, the TA recommended informing users when the revised data will be published and provide a revision analysis commentary why revisions are necessary and justified.

The NSO requested a series of technical assistance and agreed to expand data sources and to improve the compilation of data components, reconcile GDP by production and by expenditure, and introduce revision policy in line with international standards.

Annex IX. Implementation of Governance Commitments under 2020 RCFs

Please see below summary of governance commitments under the 2020 RCFs and update to the status of implementation of these commitments .

UFR	Governance Commitments	Status of implementation applies to both RCF I and RCF II
RCF I (May 2020)	"We will ensure that all government spending to manage and contain the impact of the COVID-19 pandemic is transparent and efficient. In line with our existing practices, we will regularly publish procurement documentation (including tenders, bids, and names of awarded companies, products or services procured and their costs) on the Public Procurement and Disposal of Assets (PPDA) website—this applies to all competitive bids and direct procurement by all Ministries, Agencies and Departments (MDAs). To ensure enhanced transparency and accountability, we will also publish on the PPDA website the names of the beneficial owners of the awarded companies and the results of a thorough ex-post validation of delivery; we will publish (on the Ministry of Finance website and in the press) quarterly statements on commitments and payments of COVID-19 related activities (in all MDAs); and we will specify COVID-19 related costs in our published monthly salary report (costs of hiring additional medical staff, risk allowances) as well as in our budget funding and cash management analysis. The National Audit Office will submit quarterly audits of COVID-19 related spending (across all MDAs) to the Minister of Finance (for submission to Cabinet) and, once the pandemic abates, will publish and submit to Parliament a comprehensive audit of COVID-19-related spending (across all MDAs and ADMARC)."	**Procurement contract information.** This commitment is being implemented on an ongoing basis: Publication of public procurement details can be found on the PPDA website, although not yet updated with 2021 data: https://www.ppda.mw/covid-19-procurements/ Results of ex-post validation of delivery for COVID-19 procurement have not yet been published on the PPDA website. According to PPDA, ex-post validation of delivery requires PPDA officers to carry out physical onsite inspections. This has been derailed by the intensification of the pandemic. **Beneficial ownership of contracting companies.** The beneficial ownership information of awarded companies was collected and published only for a subset of contracts that does not cover all MDAs.. **Audits.** The National Audit Office is undertaking the audits of several tranches of public funds released from the Ministry of Finance to different COVID-19 clusters in MDAs. So far, the audit report for MWK 6.2 billion was completed in March 2021, made public in April 2021 and the government has acted and is following up on the recommendations of the report. Audits for two other tranches are expected to be completed by end-December 2021. Implementation date for the comprehensive audit is "within 180 days after the end of the pandemic." **Reporting.** Quarterly statements and reports on COVID-19 related spending across all MDAs have been produced and published for FY19/20 and FY20/21, but with a significant delay due to capacity constraints. The Ministry

		of Finance has faced difficulties in separating COVID-19 spending from total spending based on data they receive from MDAs. The reports can be found here https://www.finance.gov.mw/index.php/our-documents/expenditure-reports
RCF II (October 2020)	"While continuing to implement the measures outlined in our April 27, 2020 LOI, we reiterate our strong commitment to an effective and transparent use of public funds, and to ensure that the aid received, including from the RCF disbursement, and the freed resources from the CCRT and DSSI, are efficiently spent on addressing the crisis. Specifically, we are regularly publishing procurement documentation—including tenders, bids, and names of awarded companies, products or services procured and their costs, and names of the beneficial owners of the awarded companies — on the Public Procurement and Disposal of Assets (PPDA) website (https://www.ppda.mw/#). This applies to all COVID-19 related competitive bids and direct procurement by all Ministries, Agencies and Departments (MDAs). To ensure enhanced transparency and accountability, we are also publishing on the PPDA website the results of ex-post validation of delivery on a contract-by-contract basis; we will publish (on the Ministry of Finance website and in the press) quarterly statements on commitments and payments of COVID-19 related activities (in all MDAs, within 90 days after the end of each quarter, beginning with FY 2019/20Q4); we will specify COVID-19 related costs in our published monthly salary report (costs of hiring additional medical staff, risk allowances, all within 3 weeks after the end of each month, beginning with the September 2020 report) as well as in our monthly budget funding and cash management analysis; and we will publish funding earmarked for COVID-19 related spending, including revenues from any new taxes and disbursements of development partner grants and loans (within 3 weeks after the end of each month, beginning with revenues for September 2020). The National Audit Office will submit quarterly audits of COVID-19 related spending (across all MDAs) to the Minister of Finance (within 180 days after the end of each quarter, beginning with FY 2019/20Q4) for submission to Cabinet and, once the pandemic abates, will publish and submit to Parliament a comprehensive audit of COVID-19-related spending (across all MDAs and the Agricultural Development and Marketing Corporation (ADMARC), within 180 days after the end of the pandemic)."	

INTERNATIONAL MONETARY FUND

MALAWI

November 30, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The African Department
(In Consultation with Other Departments, the World Bank, and the African Development Bank)

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FUND RELATIONS

(As of October 31, 2021)

Membership Status

Joined: July 19, 1965; Article VIII

General Resources Account:

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

SDR Department:

	SDR Million	%Allocation
Net cumulative allocation	199.40	100.00
Holdings	4.37	2.19

Outstanding Purchases and Loans:

	SDR Million	%Quota
RCF Loans	138.75	99.06
ECF Arrangements	146.88	105.82

Latest Financial Commitments:

Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	04/30/2018	09/24/2020[1]	105.84	53.85
ECF	07/23/2012	06/29/2017	138.80	138.80
ECF	02/19/2010	07/22/2012	52.05	13.88

Outright Loans :

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RCF	10/02/2020	10/06/2020	72.31	72.31
RCF	05/01/2020	05/05/2020	66.44	66.44

[1] The 2018 ECF was cancelled by the authorities on September 24, 2020 as presented in the request in the October 2020 Request for Rapid Credit Financing.

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

	Forthcoming				
	2021	**2022**	**2023**	**2024**	**2025**
Principal		25.81	22.37	23.11	33.46
Charges/Interest	0.02	0.10	0.10	0.10	0.10
Total	0.02	25.91	22.47	23.21	33.56

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative:

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	December 2000
Assistance committed	
by all creditors (US$ Million)[1]	1,057.00
Of which: IMF assistance (US$ million)	45.27
(SDR equivalent in millions)	33.37
Completion point date	Aug 2006
Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	33.37
Interim assistance	11.57
Completion point balance	21.80
Additional disbursement of interest income[2]	3.82
Total disbursements	37.19

[1] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts cannot be added.

[2] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

Implementation of Multilateral Debt Relief Initiative (MDRI):

MDRI-eligible debt (SDR Million)[1]	37.87
Financed by: MDRI Trust	14.53
Remaining HIPC resources	23.34

Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
December 2006	N/A	7.91	7.91
September 2006	10.84	19.12	29.96

[1] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Implementation of Catastrophe Containment and Relief (CCR)[1]:

Date of Catastrophe	Board Decision Date	Amount Committed (SDR million)	Amount Disbursed (SDR million)
N/A	04/13/2020	7.20	7.20
N/A	10/02/2020	7.20	7.20
N/A	04/01/2021	7.81	7.81
N/A	10/06/2021	6.72	6.72

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

Safeguards Assessments:

The 2021 safeguards assessment of the RBM is substantially completed. It found significant deterioration of safeguards at the RBM since the 2018 assessment. Governance arrangements and the internal control environment are considered weak. Governance reform should establish the Board as the RBM's main decision-making body responsible for oversight and policy formulation, and to introduce collegiality in executive management. Amendments of the central bank legal framework are needed to safeguard the central bank's autonomy and enhance collegiality in executive management. The RBM will also need to strengthen management of foreign reserves.

Exchange Arrangements:

In May 2012, the government liberalized the foreign exchange regime, devalued the kwacha by about 33 percent, and adopted a de jure floating exchange rate regime. Since May 2012, the RBM has not set a target rate and allowed substantial volatility in the exchange rate. However, the U.S. dollar exchange rates have shown remarkable stability since October 2016. Accordingly, the de facto exchange rate arrangement is classified as "stabilized". Inflows of foreign exchange and swap arrangements have allowed for increase in international reserves until 2020. The exchange regime is free of restrictions and multiple currency practices. The RBM reintroduced in August 2021 a surrender requirement to address foreign exchange shortages which is treated as a temporary measure to address extraordinary circumstances and should be lifted as conditions improve.

Article IV Consultation:

The Executive Board concluded the last Article IV consultation with Malawi on April 30, 2018.

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

A joint team of the World Bank and the International Monetary Fund visited Malawi under the FSAP program during two missions in July and December 2007. The Financial System Stability Assessment (FSSA) was issued in June 2008 (SM/08/198). An FSAP development module was conducted in mid-2017.

Corporate Governance and Accounting and Auditing ROSC missions visited Malawi in February and June 2007.

An update on the FAD mission on the fiscal transparency module was issued in March 2007. A ROSC on the data module, based on a September 2003 mission, was published in October 2004.

Technical Assistance: (since 2015, as of November 2021)

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
11/21	FAD	MOF	Supporting implementation of a new ITAS	Virtual Mission
11/21	AFE	MOF	Improving quality of general government fiscal data	Virtual Mission
11/21	AFE	NSO	Compilation of GDP expenditure and production	Virtual Mission
09/21	AFE	MOF	Using tax data for GDP compilation	Virtual Mission
09/21	FAD	MOF	Developing a VAT compliance improvement plan	Virtual Mission
09/21	FAD	MOF	Integrating performance budgeting and IT systems	Virtual Mission
09/21	FAD	MOF	Excise management	Virtual Mission
08/21	AFE	MOF	Strengthening project appraisal and selection	Virtual Mission
07/21	AFE	NSO	Continued compilation of GDP expenditure	Virtual Mission
07/21	FAD	MOF	Audit of high risk sectors for VAT	Virtual Mission
06/21	STA	NSO	CPI Update	Virtual Mission
05/21	MCM	RBM	Principles for financial market infrastructures training	Workshop
05/21	MCM	RBM	Review of oversight framework	Workshop
04/21	STA	RBM	Monetary and financial statistics	Virtual Mission
04/21	FAD	MOF	Strengthen excise management	Virtual Mission
03/21	STA	RBM	External sector statistics	Virtual Mission
12/20	AFE	NSO	National accounts: Review and assist to compile GDP by production	Virtual Mission
09/20	FAD	MOF	Develop a revenue action plan to mitigate the impact of COVID-19	Virtual Mission
08/20	FAD	MOF	Fiscal risks during COVID-19	Virtual Mission
07/20	AFE	NSO	COVID-19 Prices: Compiling PPI and IIP weights	Virtual Mission
07/20	AFE	NSO	COVID-19 National Accounts: Compilation of the supply table	Virtual Mission
06/20	FAD	MOF	Fiscal reporting: Completing the cash basis IPSAS implementation	Virtual Mission
06/20	FAD	MOF	Implementing Msonkho online	Virtual Mission
02/20	FAD	MOF	Public sector balance sheet	Mission
02/20	FAD	MOF	Developing a revenue mobilization strategy	Mission
01/20	MCM	RBM	Projection of the Central Bank balance sheet	Mission
12/19	FAD	MOF	Assessing tax and customs administration reform progress	Mission
11/19	AFE	NSO	Compilation of the supply table	Mission

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
08/19	AFE	NSO	Updating PPI and IIP weights	Mission
08/19	MCM	RBM	Cyber risk supervision	Mission
07/19	MCM	RBM	National payment system	Mission
07/19	FAD	MOF/RBM/NSO	Macro-fiscal forecasting	Mission
07/19	STA	NSO	Supply and use tables	Mission
04/19	MCM	RBM	Monetary policy operations	Mission
04/19	STA	NSO	External sector statistics	Mission
04/19	STA	NSO	National Accounts	Mission
04/19	STA	MOF	Government finance statistics	Mission
03/19	MCM	RBM	Local currency bond market	Mission
02/19	FAD	MOF	TSA/IFMIS	Mission
02/19	ICD	RBM	Forecasting and Policy Analysis System	Mission
12/18	FAD	MOF	Revenue administration	Mission
12/18	STA	MOF	Government finance statistics	Mission
12/18	FAD	MOF	Building effective taxpayer registers	Workshop
11/18	STA	NSO	National Accounts	Mission
10/18	FAD	MOF	PFM	Mission
10/18	FAD	MOF	Revenue administration	Mission
10/18	ICD	RBM	Policy analysis and forecasting	Mission
10/18	MCM	RBM	Insurance Supervision and Regulation	Mission
09/18	FAD	MOF	Revenue administration	Workshop
08/18	FAD	MOF	Macro-fiscal forecasting	Mission
08/18	FAD	MOF	PFM/ IFMIS	Mission
06/18	STA	MOF	Government finance statistics	Workshop
06/18	MCM	MOF/RBM	Developing Local Securities Market	Mission
06/18	FIN/LEG	RBM	Central Bank law	Mission
06/18	FAD	MOF	PFM/Budget Execution and Controls	Mission
06/18	FAD	MOF	Strengthening oversight of SOEs	Mission
05/18	STA	NSO	National accounts	Mission
04/18	FAD	MOF	Public Investment Management	Mission
03/18	STA	NSO	National Accounts	Mission
03/18	STA	RBM	Monetary and financial statistics	Mission
03/18	STA	MOF	Government finance statistics	Mission
03/18	FIN/LEG	RBM	Safeguards Assessment Mission	Mission
03/18	FAD	MOF	PFM/ Fiscal risk	Mission
03/18	FAD	MOF	Revenue Administration	Mission
03/18	ICD	RBM	Policy analysis and forecasting	Mission
03/18	STA	RBM	Monetary and financial statistics	Mission
02/18	FAD	MOF	PFM / Financial controls	Mission
02/18	STA	RBM	Monetary and financial statistics	Mission
02/18	FAD	MOF	Customs administration	Mission
01/18	STA	NSO	External sector statistics	Mission
01/18	STA	NSO	Price statistics	Mission
12/17	FAD	NSO	National accounts	Mission

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
12/17	FAD	MOF	Budgeting	Mission
12/17	FAD	MOF	Tax administration	Workshop
11/17	STA	MOF	Government finance statistics	Workshop
11/17	MCM	RBM	Financial sector regulation	Mission
11/17	MCM	RBM	Banking supervision	Mission
11/17	STA	NSO	National account statistics	Mission
11/17	FAD	MOF	Debt management system	Mission
11/17	MCM / WB	RBM / MOF	Debt management strategy	Mission
10/17	STA	MOF	Government Financial Statistics	Mission
09/17	STA	NSO	Price Statistics	Mission
09/17	ICD	RBM	Policy analysis and forecasting	Mission
08/17	FAD	MOF / MOF / NSO	Macroeconomic forecasting	Mission
08/17	ICD	RBM	Policy analysis and forecasting	Mission
08/17	FAD	MOF	Public financial management	Mission
07/17	MCM	RBM	Forex operations and repo market	Mission
05/17	ICD / MCM	RBM	Forecasting / Policy Analysis System	Mission
05/17	FAD	MOF	Customs administration	Mission
05/17	FAD	MOF	Cash management and TSA	Mission
04/17	STA	RBM	Financial soundness indicators	Mission
04/17	FAD	MOF	Compliance risk analysis	Mission
04/17	FAD	MOF	Cash management	Mission
03/17	MCM	RBM	Financial market infrastructure	Workshop
01/17	MCM	RBM	Bank supervisory framework	Mission
01/17	ICD / MCM	RBM	Monetary policy framework	Mission
11/16	FAD	MOF	Taxpayer register	Mission
10/16	FAD	MOF	Risk management in customs	Mission
10/16	ICD / MCM	RBM	Forecasting / Policy Analysis System	Training
09/16	STA	RBM	General Data Dissemination System	Mission
09/16	FAD	MOF	PFM / Financial controls	Mission
08/16	STA	NSO	Consumer price Framework	Mission
07/16	ICD	MOF	Government financial statistics	Training
06/16	STA	NSO	National accounts statistics	Mission
06/16	LEG	RBM	Bank resolution	Workshop
05/16	MCM/ICD	RBM	Monetary policy framework	Mission
04/16	FAD	MOF	PFM	Mission
04/16	MCM	RBM	Basel framework	Mission
04/16	STA	NSO	National accounts statistics	Mission
03/16	MCM	RBM	IT risk	Mission
02/16	LEG	RBM	Safeguard assessment	Mission
02/16	MCM	RBM	Foreign exchange interventions	Mission
01/16	LEG	RBM	AML/CFT supervision	Mission
01/16	FAD	MOF	Tax reform	Mission

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
11/15	MCM	RBM	Interbank money market	Mission
11/15	FAD	MOF	Fiscal reporting	Mission
10/15	MCM	RBM	Repo market and forex swaps	Workshop
10/15	STA	NSO	National accounts statistics	Mission
09/15	FAD	MOF	Pension reform proposals	Mission
09/15	FAD	MOF	Expenditure control, bank reconciliation, and fiscal reporting	Mission
07/15	FAD	MOF	Cash planning and management	Mission
06/15	STA	NSO	Price Statistics	Mission
05/15	FAD	RBM	TADAT Pilot Assessment	Mission
04/15	FAD	MOF	Implementing priority PFM reforms II	Mission
04/15	STA	NSO	National Accounts Statistics	Mission
03/15	LEG	RBM	Helping draft Banking law amendments	Mission
03/15	STA	MOF	Government Finance Statistics	Mission
02/15	STA	NSO	Balance of Payments Statistics	Mission
02/15	STA	NSO	National Accounts Statistics Harmonization	Workshop
02/15	MCM	RBM	Advice on the Implementation of ICAAP/SREP supervisory framework.	Mission
01/15	FAD	MOF	Action plan for implementing priority PFM reforms	Mission

JOINT MANAGERIAL ACTION PLAN

(As of November 9, 2021)

Title	Products	Expected Delivery Date
A. Mutual Information on Relevant Work Programs		
World Bank work program in the next 12 months	**Analytical and Advisory Activities:**	
	1. Impact Evaluation of Emergency Response and Post Crash Care in Malawi and Tanzania	April 29, 2022
	2. Using Remote Tracking to Detect and Deter Medications Theft in Malawi	December 22, 2021
	3. Malawi Poverty Assessment FY21	March 28, 2022
	4. Malawi Economic Monitor	May 31, 2022
	5. Malawi: Overcoming Challenges to Transform Human Capital	May 20, 2022
	6. Malawi Country Gender Assessment and Evaluation of Coordinated Response to GBV/SEA.	November 30, 2021
	7. Malawi Transport InfraSAP2.0	June 30, 2022
	8. Malawi programmatic poverty analysis on project outcomes and poverty/vulnerability using RFMS	June 2, 2023
	9. Malawi: Energy Sector Financial Strengthening	August 31, 2022
	10. Mobilizing Long-term Finance in Malawi	June 28, 2022
	11. Malawi Country Climate and Development Report	July 29, 2022
	12. Malawi: A Deep-Dive Study for Promoting Resilient Urban Development and Driving Sustainable Regional Growth	June 22, 2022
	13. Malawi Programmatic JET Country Economic Memorandum	April 14, 2023
	14. Malawi Gender Platform	March 29, 2024
	Lending	
	1. Lilongwe Water and Sanitation Project- Additional Financing	December 16, 2021
	2. Agriculture Sector Wide Approach Support Project II Additional Financing	December 31, 2021
	3. Shire Valley Transformation Program - Phase 2	June 21, 2022
	4. Social Support for Rural Livelihoods Project Additional Financing	May 31, 2022
	5. Additional Financing for Malawi COVID-19 Emergency Response and Health Systems Preparedness Project	May 13, 2022
	6. Mpatamanga Hydro Power Project	April 5, 2022
	7. Malawi Growth and Resilience Development Policy Financing	April 29, 2022
	8. Malawi Transport Asset Management and Safety Project	July 28, 2022
	9. Sustainable Transmission and Energy Access in Malawi	October 25, 2022

B. Requests for Work Program Inputs		
IMF request to World Bank	1. Updates on WB support to Malawi	Continuous
World Bank request to IMF	1. Regular updates and exchange of views on medium-term macroeconomic and fiscal projections including sharing detailed excel tables on Real, Monetary, Fiscal and External Sectors	Continuous
C. Agreement on Joint Products and Missions		
Joint products in next 12 months	1. Debt Sustainability Analysis (update)	December, 2021

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK

(As of November 2021)

The African Development Bank (AfDB) operations in Malawi date back to 1969. The AfDB Group Malawi Country Office was opened in 2007. As of September 30, 2021, the AfDB had provided significant and diversified support to Malawi, with cumulative commitments worth UA 1,010.2 billion (about US$1.4 billion) to finance 116 operations, including thirteen studies and two lines of credit.

The AfDB' s Malawi Country Strategy Paper (CSP) covering the period 2018-2022 is fully aligned with the third Malawi Growth and Development Strategy (MGDS III, 2017-22), Malawi Vision 2063, and the AfDB's corporate priorities in the Long-Term Strategy (LTS, 2013–22) and High 5 priorities.

The current CSP 2018-2022, aims to support the foundations of private sector led growth by investing in infrastructure and promoting diversification and transformation agenda. In this regard, the CSP covers two pillars. Pillar I: *Investing in infrastructure development through energy and transport; and* Pillar II: *Investing in economic transformation by strengthening agriculture value addition and developing water infrastructure*.

The strategic objective of pillar 1 is to improve competitiveness and efficiency of private and public sector, by extending infrastructure, limiting bottlenecks, and reducing investment constraints that increase business transaction costs. The outcomes to this pillar include improved connectivity to local and regional markets, reduced transport costs, and increased private sector investment in energy and transport. Similarly, the strategic objective of pillar 2 is to boost economic diversification and build resilience by reducing cost of market entry, underpinning the creation of firms and jobs that contribute to the broadening the tax base and enhancing macro-stability. The outcomes for pillar 2 include increased productivity and production, increased market development and diversification, empowered local communities and improved health and wellness.

Given the rapidly growing population, it is critical that the economy starts creating more economic opportunities that would generate increased revenues for the government to efficiently and effectively provide required social services and public goods, while ensuring a dynamic and growing private sector.

Crosscutting themes are mainstreamed into the CSP and are an integral part of lending and non-lending operations. Environment and climate change, skills and training especially amongst the youth, and economic and financial governance are the central cross-cutting areas in operations selected for support.

Since the CSP approval in October 2018, as of 30 September 2021, the Bank had approved 9 new projects amounting to about USD 220.64 million (UA157.6 million) over the period 2018–2020, in the water, agriculture, and roads sectors in line with the CSP priorities. About 62% (UA 97.6 million) of the approved resources were secured from the African Development Fund; while the remaining balance came from Nigerian Trust Fund, Global Environmental Facility and Special Relief Fund. The recently approved projects includes: (i) Nkhata Bay Town Water Supply and Sanitation Project (USD 15 million) in October 2018; Shire Valley Transformation Programme (USD 35 million) in December 2018; (iii) Additional Financing to Sustainable Rural Water and Sanitation Infrastructure Project (USD 2.5 million) in May 2019; (iv) Post Cyclone IDAI Emergency Recovery for Malawi (USD 22.5 million) in June 2019; and (v) the Multinational Nacala (Nsipe-Liwonde Rehabilitation) Road Project (USD 37 million) in June 2019. In April 2019, (vi) the AfDB also approved an Emergency Relief Assistance to the tune of USD 1.5 million (USD 1 million to Mozambique and USD 250,000 each to Malawi and Zimbabwe). The grant resources aimed to contribute to Government efforts in meeting the urgent and immediate needs of the households affected by Cyclone IDAI. In October 2019, the (vii) the Sustainable Fisheries and Aquaculture development project was approved totaling USD 13.44 million (UA 9.6 million). During July 2020, the Bank Board approved two projects: (viii) Financing for promoting competitiveness in tourism amounting to USD 980,000 (UA 0.7 million), and in July 2020, (ix) a COVID-19 Response Support Program (a budget support operation) amounting to USD 46 million (UA 32.9 million).

Through a strong partnership with the EU, the AfDB has managed to secure 18 million Euros (grant) on 25th February 2019 to co-finance the Multinational Nacala Road Corridor Development Project Phase V. In support of the Nkhata Bay Town Water Supply and Sanitation Project, the AfDB is administering OPEC Fund for International Development (OFID) USD 12 million loan.

For the remaining period 2021-2022, four planned projects are being prepared for approval including: (i) Digitalization, Financial Inclusion and Competitiveness Project for USD 13.7 million (due in the year 2021), (ii) Africa Disaster Risk Financing (ADRiFi) worth USD 4.9 million) (due for approval in 2021), (iii) Agriculture Commercialization, Value Addition & Youth Agribusiness Project amounting to USD 20 million (due in 2022), and (iv) Rehabilitating and Upgrading of M5 Road (North-South Road Corridor Project – Benga-Nkhotakota-Dwangwa Road (USD 49.7 million) planned to be approved in early 2022

These interventions aim at strengthening economic transformation by enhancing agriculture value chains, increasing mechanization, increasing access to finance, improving market linkages, and supporting crop diversification. These will underpin new income opportunities for emerging commercial farmers while strengthening linkages to small-scale farmers with increased focus on women and youth. Small industry development will be supported through agro-processing and light industrialization that will contribute to expand the economy and create jobs. The interventions in the water sector are expected to increase capacity of water reservoirs, small dams harvesting schemes, and improve access to potable water to free up time in rural areas especially for women: to allow them focus on other social economic activities. The interventions will support water resource management in key water basins such as Songwe River and Lake Malawi that impact on other sectors, such as energy, agriculture, tourism, and fisheries.

In the recent past, the AfDB has also provided Malawi with quick disbursing budget support. Following the government’s re-engagement with the IMF and the approval of the US$157 million Extended Credit Facility (ECF) arrangement in July 2012, the AfDB approved an ADF Grant for Crisis Response Budget Support operation, for USD40 million. The AfDB designed the Restoration of Fiscal

Stability and Social Protection (RFSSP) program whose objective was to contribute to restoring fiscal stability and enhancing public finance management, as well as support social protection measures to mitigate the adverse social impact of the devaluation of the kwacha and the increases in fuel and electricity prices. To support this agenda, the RFSSP had two components to strengthen: PFM transparency and accountability, and social protection systems.

In 2015, the African Development Fund Board approved a grant of USD 30 million for the Protection of Basic Services Program (PBS). This ring-fenced Sector Budget Support was designed to protect critical expenditures in health and education, and improve accountability following suspension of general budget support. The grant was disbursed in one tranche in July 2015. The Food Crisis Response Budgetary Support followed the PBS operation in 2016. The AfDB will continue to coordinate closely with the IMF in the design of its future budget support operations to ensure its programs are underpinned by sound macro-economic policies.

The AfDB alongside other development partners are working in support of strengthening Malawi's public finance management (PFM) systems. In support to the implementation of PFM reforms and in strengthening internal control systems following 'cashgate', the AfDB approved two PFM Institutional Support Projects (USD 7 million), one of which closed in June 2018 and the other closed in December 2019. Among others, the Bank has supported the country to review the PFM Act, which builds on previous support of the Bank under PFMSPII. Through AfDB's COVID-19 Budget Support project that was approved in July 2020, the government has published the COVID-19 procurements. The other previous key areas of AfDB PFM support focused on tax administration reforms (upgrading of the Automated System for Customs Data—ASYCUDA, putting in place a Tax Appeals Tribunal legislative framework, review of the Customs and Excise Act, etc.); public procurement reforms; and strengthening financial management systems, Treasury Instructions, Treasury Funds Management Guidelines, undertaking an audit of Treasury Funds, and strengthening the Integrated Financial Management Information System (IFMIS) oversight, among others.

In terms of private sector support, the AfDB supported a number of private sector projects directly and indirectly through regional operations and private equity (PE) funds. The AfDB approved, in 2017, a USD 300 million long-term senior loan to finance the Nacala Rail and Port Project, which is a regional project. The loan included an allocation of USD 18.1536 million to Central African Railways Company Limited (CEAR) of Malawi. The project will provide Malawi with a more efficient access to a sea port and will therefore lead to a reduction in transportation costs for import and export trade. To complement the Nacala Rail and Port Project and the Nacala Roads Projects and in order to support inclusive growth along the Nacala Development Corridor in Malawi, the AfDB approved a USD 1 million Nacala Rail and Port Value Additional TA Project. The TA project will help local SMEs and farmers take advantage of the road and rail infrastructures by improving on the efficiency and competitiveness of their businesses. The AfDB also approved, in 2016, a soft commodity finance facility of USD 20 million (a regional project) to Meridan Consolidated Investment Limited. The funds approved will be used to purchase soft commodities (i.e. maize, groundnuts, pigeon peas, soya, sesame and beans) directly from small-scale farmers in Malawi, Mozambique and Zimbabwe.

Meridan Consolidated Investment Limited is originally a Malawian company that has expanded its operations regionally.

The AfDB has also provided support for non-lending activities, including feasibility studies and analytic work, to inform the design of new operations and policy dialogue. In 2017, the AfDB prepared a feasibility study for Kholombidzo Hydro Power Project, which will provide a foundation for pipeline operations. In the same year, the AfDB financed the feasibility study for establishment of an Agriculture Cooperative AfDB. Based on the findings and recommendations of the feasibility study, the Government of Malawi recently launched the Malawi Agricultural and Industrial Investment Corporation Plc which is a government initiative to establish a development AfDB in the country but being led by the private sector.

In addition, the AfDB is supporting the Private Public Partnership Commission (PPPC) with a grant to build PPP negotiation capacity through a "hot line" arrangement, whereby the PPPC can tap into international legal services to advise on PPP transactions. The AfDB has provided technical assistance to the Malawi Postal Cooperation for the development of the E-Post Strategy and Action Plan. It is to be noted that the AfDB, in recent years, has undertaken a number of analytical studies, including Domestic Resource Mobilization Study for Malawi, and provided TA to the Reserve AfDB of Malawi to strengthen capacity in macro-economic forecasting; prepared a Public Expenditure Review with the World Bank and other development partners; and provided support for undertaking of the Expenditure Tracking Study for Malawi.

Looking forward, the AfDB plans to scale up its lending to the energy sector with a view to address power shortages. The pipeline of energy sector projects includes the Songwe River Basin Development Project, the Malawi-Zambia Power Inter-connector Project, and the Kholombidzo Hydro Power Project. The AfDB continues to engage with the World Bank and other partners for co-financing arrangements of its pipeline operations. In view of this, the AfDB is taking the lead in mobilizing donor resources and private finance for the Songwe Hydro Power Project, a multinational project with Tanzania. It will also promote private investment in the energy sector, through PPPs and the use of innovative financing instruments, such as Partial Risk Guarantees. Specifically, for the period 2021-2022, the Bank is considering three projects for financing from the Non-Sovereign operation private sector window including: Voltalia Kanengo Dzuwa Limited (VKDL Solar Project), Mbongozi Hydro Electric Project, and Mpatamanga 350MW hydro project.

The AfDB undertook a mid-term review of the Country Strategy Paper (2018-2022) in 2020, to take stock of achievement of results and aligned with Malawi's new National Development Plan and the Bank's Long Term Strategy, in particular, the "High Fives" priorities, which include "Light up and Power Africa", "Feed Africa", "Industrialize Africa", "Integrate Africa" and "Improve the Quality of Life for the People of Africa". During 2022, the AfDB will prepare a project completion report for the Country Strategy Paper (2018-2022) to guide the formulation of its new Country Strategy for the period 2023-2027.

STATISTICAL ISSUES

(As of November 15, 2021)

I. Assessment of Data Adequacy for Surveillance

General: Data provision has shortcomings that are serious and significantly hamper surveillance. Most affected areas are: national accounts, fiscal, monetary and external sector statistics.

National Accounts: GDP was rebased from 2010 to 2017. Malawi's nominal GDP for 2017 has been revised upwards by 38.4 percent from MK4,635.4 billion (US$6.35 billion) in the 2010 base year to MK6,417.3 billion (US$8.8 billion) in the 2017 base year. STA is providing a series of technical assistances (TA) to the National Statistics Office (NSO) on reconciling GDP by expenditure and GDP by production with rebased figures. Currently, GDP by production and by expenditure has a discrepancy of around 14 percent, which could be a shortcoming that significantly hampers surveillance. Available data sources are investigated and recommended for utilization to improve the quality of the GDP series and the NSO is planning to introduce a revision policy before end-2022.

Price Statistics: The NSO will be updating the CPI using expenditure data from the 5th Integrated Household Survey (IHS5), which was conducted from April 2019 to April 2020. Current CPI weights are based on the results of the 4th Integrated Household Survey (IHS4) which was conducted during 2016-2017. In response to a request from the National Statistical Office of Malawi (NSO) and in support of the AFRITAC East (AFE) work program, technical assistance (TA) missions assisted with updating the consumer price index (CPI) in 2021. The missions assisted in computing the more up-to-date weights from expenditure data generated by the 5th IHS and according to COICOP.

The producer price index (PPI) is based on weights derived from the results of the Annual Economic Survey conducted in 2012. The weights should be updated, and coverage of the index expanded to other production activities, so as to better reflect the current structure of the economy.

The NSO is in the process of developing export-import price indexes.

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

- Due primarily to differences in coverage, published data for the budgetary central government include a sizeable statistical discrepancy between above and below the line data.

The coverage of government for above the line data is considerably narrower than the information on financing reported by RBM.

- While tax revenue data are received in a timely fashion, it is not always possible to reconcile them with deposits in the Malawi Government (MG) Account. This is a result of the way taxes are reported, and timing differences between receipt of taxes and cleared funds being available for the government. The finances and operations of the Malawi Revenue Authority are also unusually opaque.

- Nontax revenue, including capital revenues collected by line ministries, is not properly accounted for in the fiscal reports prepared by the Ministry of Finance.

- The Ministry of Finance does not include zero-coupon promissory notes, recently issued to clear arrears, in its fiscal reporting.

- Interest payments are currently reported on a currency basis rather than based on the residency of the holder of the security.

The authorities have received significant technical assistance from the Fund and other donors to strengthen expenditure monitoring and reporting, accounting, and statistical reporting, but results have lagged. The government has pledged to strengthen public financial management and fiscal reporting. The new IFMIS has been rolled out to all MDAs on 1 July 2021, and authorities are working to produce comprehensive fiscal reports using the new system. The authorities are currently working with East AFRITAC to modify the chart of accounts and output-based structures so that they could more easily be realigned to the national strategy and be more readily understood.

Annual government finance data for the Budgetary Central Government in a GFSM 2014 presentation are reported for publication in the Government Finance Statistics Yearbook (GFSY). However, these data are not disseminated domestically. STA TA missions have encouraged the authorities to compile and report high frequency data for Budget Central Government in GFSM 2014 framework and assisted them in compiling data for extrabudgetary units (EBUs) with the objective of expanding coverage to central government.

Monetary and Financial Statistics: The Reserve Bank of Malawi (RBM) has started to compile and report monetary data to STA using standardized report forms (SRFs). On April and May 2021, STA provided a TA mission to RBM to address outstanding issues in SRF and RBM has moved completely to reporting in SRFs.

Financial Sector Surveillance: In response to a request from the Reserve Bank of Malawi (RBM), a technical assistance (TA) mission assisted RBM in improving its monetary operations framework and to facilitate the development of the broader financial markets in April 2019. MCM provided a mission to the RBM on domestic asset management strategy which took place in January 2020.

External sector statistics (ESS): The NSO compiles annual trade and balance of payment (BOP) data. Previously trade data submission had more than nine months of lag, and the latest available Balance of Payment (BOP) data is for 2016. The international investment position (IIP) data is available up to 2019. The lack of timeliness and accuracy of the ESS significantly hampers the staff's work on projection and macroframework of the external sector development. The ESS mission conducted by STA in March 2021 focused on improvements of the coverage, compilation, and timeliness of goods trade data, along with assessment of the BOP and IIP data compilation to follow up a previous TA mission. The mission noted the issues in areas of source data collections as well as physical and human resource capacity. As of October 31, 2021, the NSO provided goods trade data up to March 2021. The timeliness of dissemination of the trade data needs to be accelerated to (at least) within two months from the end of a reference month as the STA mission recommended, especially given that no reliable BOP data is available. The daily exchange rate data, monthly international reserves data as well as the FXI data are regularly reported from the Reserve Bank of Malawi (RBM). The reported international reserves data follow closely the data template on International Reserves and Foreign Currency Liquidity (IRFCL). The RBM has started reporting an independent line for the estimated size of pledged deposits. The value of pledged deposits is, however, subject to change upon the completion of the special audit of foreign exchange reserves. The RBM also started to submit a daily FX cashflow table on a regular basis. Regarding the external debt data, the government of Malawi (GOM) now provides granular breakdowns on top of the end-year stock data. In the current conjuncture of Malawi's extremely vulnerable position to the external sector, reliable and timely ESS reporting is essential for diagnoses of any developments in the external sector. To move forward with improvements, the NSO, RBM and the GOM should coordinate further and take appropriate steps to implement TA recommendations to ensure a regular flow of data from this system for trade, BOP and IIP compilation; and the government should allocate sufficient resources for conducting regular surveys.

II. Data Standards and Quality	
Malawi implemented the e-GDDS and its National Summary Data Page (NSDP) went live on November 15, 2016 (http://cb.malawi.opendataforafrica.org/uwkhibc/national-summary-data-page-nsdp). The authorities are aiming at improving performance against the timeliness benchmarks that they have set under the e-GDDS.	Data ROSC was published on February 17, 2005.

Malawi: Table of Common Indicators Required for Surveillance
(As of October 30, 2021)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8] Data Quality — Methodological soundness[9]	Memo Items:[8] Data Quality — Accuracy and reliability[10]
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/2021	11/2021	D	W	W		
Reserve/Base Money	09/2021	11/2021	M	M	M		
Broad Money	09/2021	11/2021	M	M	M		
Central Bank Balance Sheet	09/2021	11/2021	M	M	M	LO, LO, LNO, O	LO, O, O, O, O
Consolidated Balance Sheet of the Banking System	09/2021	11/2021	M	M	M		
Interest Rates[2]	09/2021	11/2021	M	M	M		
Consumer Price Index	09/2021	11/2021	M	M	M	O, LNO, O, O	LNO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA.	NA					
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	09/2021	10/2021	M	M	I	O, LO, O, O	O, LO, O, O, LNO
Stocks of Central Government and Central Government-Guaranteed Domestic Debt[5]	06/2021	10/2021	M	M	M		
External Current Account Balance	2000	04/2021	A	A	A		
Exports and Imports of Goods and Services	2020	10/2021	A	A	A	O, O, O, O	LO, O, LO, O, O
GDP/GNP	2020	06/2021	A	A	A	LO, LNO, LNO, LO	LNO, LNO, LO, LO, LNO
Gross External Debt	06/2021	10/2021	A	Q	I		
International Investment Position[6]	2000	04/2021	A	A	A		

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

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

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

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

[5] Including currency and maturity composition.

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

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

[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

[9] Reflects the assessment provided in the data ROSC or the Substantive Update (published on March 10, 2004, and based on the findings of the mission that took place during May 8–21, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording, respectively, are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[10] Same as footnote 9, except referring to international standards concerning, respectively, source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

MALAWI

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

November 30, 2021

Approved By
Vivek Arora and Bjoern Rother (both IMF), Marcello Estevão and Asad Alam (both IDA)

Prepared by the International Monetary Fund and the International Development Association.[1]

Malawi: Joint Bank-Fund Debt Sustainability Analysis[2]	
Risk of external debt distress	*High*
Overall risk of debt distress	*High*
Granularity in the risk rating	*Unsustainable under current policies*
Application of judgment	*No*

In comparison to the previous Debt Sustainability Analysis (DSA), Malawi's risk of external debt distress has been downgraded from moderate to high risk of debt distress and overall public debt has been maintained at high risk of debt distress. Granularity in risk rating has changed and staff now assess that the overall and external public debt are unsustainable under current policies. Large financing needs in the coming years and low level of international reserves suggest high risk of future distress. The change is due to significant debt vulnerabilities that emerged since the last DSA as reflected in large and protracted threshold breaches on one of two debt stock burden indicators and both of the debt service burden indicators. Debt burden indicators in this DSA (relative to the previous DSA) deteriorated due to: (i) a downgrade in the debt carrying capacity from medium to weak; (ii) a change in the definition that external debt is based on, from a currency to a residency basis, which accurately classifies and captures medium-term domestic bond held by nonresident as external debt; and (iii) the conversion of the Reserve Bank of Malawi's (RBM) short-term reserve liabilities to medium-term external debt.

[1]The current DSA follows the revised Debt Sustainability Framework (DSF) for LICs and Guidance Note (2017) in effect as of July 1, 2018.

[2]Malawi's debt-carrying capacity based on the Composite Indicator (CI), which is based on the October 2021 WEO and the 2020 WB's CPIA, is assessed as weak. The CI score is 2.56.

Despite the challenging macroeconomic situation, the authorities remain committed to prioritizing debt service payments and Malawi remains current on all its debt obligations. Malawi has been severely affected by the pandemic. It is a fragile economy with elevated poverty rates, food insecurity and frequent weather-related shocks. Moreover, substantial development and social spending needs, a high debt burden from the past, and much lower budget support and grants financing are contributing to sustained fiscal and current account deficits in the near to medium term. Thus, total public debt is projected to increase over the near to medium term but at the same time, Malawi's exposure to financing risks is significant. Staff assess the main risk to the baseline is a sudden stop of available financing especially from the regional development banks (RDBs).[3] If this risk materializes, an abrupt forced adjustment becomes inevitable, with a significant impact on growth, financial stability and the most vulnerable segments of the population.

[3] Regional Development Banks (RDBs) also include other financial institutions, such as export credit agencies and exclude African Development Bank.

PUBLIC DEBT COVERAGE

1. The DSA covers central government debt, central government guaranteed debt, and central bank debt contracted on behalf of the government (Text Table 1).[4] Public debt used for this DSA is public and publicly guaranteed (PPG) external and public domestic debt, covering debt contracted and guaranteed by the central government and the Reserve Bank of Malawi (RBM). Due to data limitations, it does not include debt held by state and local governments, other elements in the general government (such as the social security fund and extra budgetary funds), or non-guaranteed state-owned enterprise (SOE) debt.[5]

Text Table 1. Malawi: Coverage of Public Sector Debt, 2020

	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	

Public debt coverage and the magnitude of the contingent liability tailored stress test

1	The country's coverage of public debt	The central government, central bank, government-guaranteed debt		
		Default	Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0 percent of GDP	2	Limited coverage
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2	
4	PPP	35 percent of PPP stock	0.00	
5	Financial market (the default value of 5 percent of GDP is the minimum value	5 percent of GDP	5	
	Total (2+3+4+5) (in percent of GDP)		9.0	

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%.

BACKGROUND

2. This DSA is being conducted in the context of the 2021 Article IV Consultation. The last Low-Income Country DSA (LIC-DSF) was considered by the Executive Board in October 2020 as part of the request for disbursement under the Rapid Credit Facility (RCF).[6] Malawi is subject to the IDA Sustainable Development Finance Policy (SDFP) which is the successor of Non-Concessional Borrowing Policy (NCBP).[7]

[4] The definition of external and domestic debt uses a residency criterion.

[5] The contingent liabilities shock from the SOE debt is kept at the default value of 2 percent to reflect risks associated with non-guaranteed SOE debt, currently excluded from the analysis due to data availability constraints.

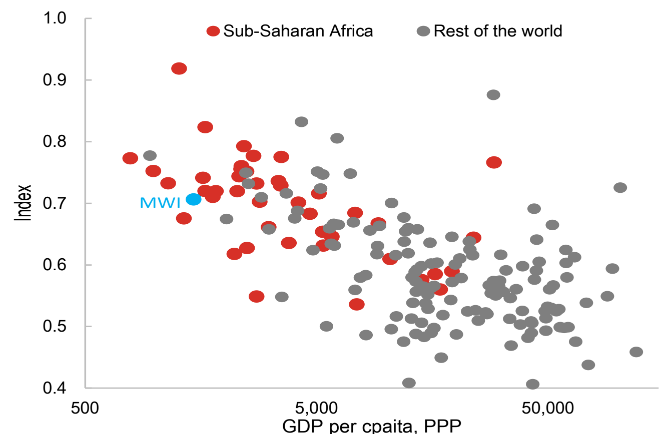
[6] This DSA is prepared jointly by the staff of the IMF and World Bank, in collaboration with the authorities of Malawi. The last joint DSA can be found in IMF Country Report No. 20/288, October 2020.

[7] The World Bank's Sustainable Development Finance Policy (SDFP) approved in 2020 builds on lessons learned from the Non-Concessional Borrowing Policy (NCBP) to further strengthen the focus on debt sustainability and debt transparency. Malawi has implemented a Performance and Policy Actions (PPAs) related to Debt Transparency, Debt management, and Fiscal Sustainability. Among these one relates to a zero non-concessional borrowing ceiling in FY21. Malawi satisfactorily implemented its FY21 PPAs and is now preparing 3 PPAs for FY22. Under the SDFP,

(continued)

3. Malawi's sources of fragility are driven by high poverty rates, food insecurity and frequent weather-related shocks, leaving per capita income stagnant. Malawi is one of the most vulnerable countries to climate change and has the third lowest GDP per capita in sub-Saharan Africa (Text Figure 1). Major droughts, floods, combined with the fallout from the COVID-19 pandemic weigh heavily on economic activity and incomes. These challenges are compounded by weak governance, and poor quality of public administration combined with limited fiscal space and high public debt. High public debt has, in turn, contributed to high real interest rates, which further weighs on lending to the private sector and growth. Thus, sustaining Malawi's growth in the past decade has been challenging. As a result, GDP growth barely kept up with population growth, leaving real per capita growth in the negative region. Moreover, exiting from fragility is not expected in the medium term as debt levels are projected to increase and crowd out private sector investment and to hinder medium-term economic prospects.

Text Figure 1. Malawi: Vulnerability to Climate Change Erodes GDP per Capita, 2019
(Index)



Source: Notre Dame Global Adaption Initiative; and IMF World Economic Outlook

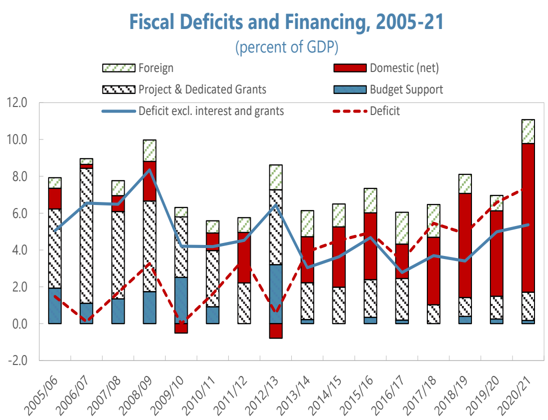
4. Substantial development and social spending needs, a high debt burden from the past, and much lower budget support and grants are contributing to sustained fiscal and current account deficits in the near to medium term. Budget deficits have remained high, reflecting limited adjustment in spending and low domestic revenue mobilization. Deficits have been financed mainly by costly domestic borrowing, as external budget support and grants financing (that averaged 5.8 percent of GDP during 2005-13) have been reduced significantly (1.8 percent of GDP) since the 2013 "Cashgate".[8] Rising domestic financing (since 2018) as well as borrowing from regional development banks (RDBs) on non-concessional basis has significantly increased Malawi's public debt which stood at 55 percent of GDP in 2020. Non-concessional external debt outstanding of 10 percent of GDP in 2020, mostly financed fuel, fertilizer, and other strategic imports (Text Figure 2; Text Table 2).

countries under LIC DSF in debt distress with unsustainable outlook, a zero ceiling on non-concessional borrowing applies. A non-zero ceiling could be considered, for example, for arrears clearance operations only if other financing options are not available. Ex-ante exceptions to the framework may be granted in cases where non-concessional borrowing is linked to projects with high economic, financial and social return.

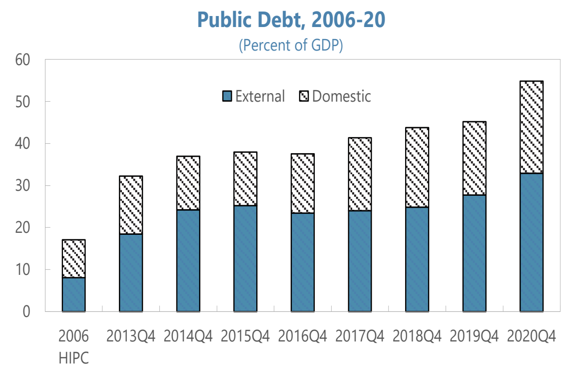
[8] "Cashgate", a major corruption case that led to arrests, trials and convictions of a number of civil servants.

Text Figure 2. Malawi: Fiscal Challenges Confronting a Fragile Economy, 2005-21

Budget support (blue) and grants have been replaced by domestic borrowing (red), hiking overall deficits despite a gradual reduction in domestic primary deficits through FY16/17.



As a result, at end-2020, public debt rose to 55 percent of GDP and external debt rose to 33 percent of GDP (a third of which is at nonconcessional terms).



Source: Malawian authorities; IMF staff estimates.

5. **Regional Development Banks' (RDBs') participation in the domestic bond market increased the share of commercial debt to 33 percent of total external PPG debt**. The total external PPG debt stock reached $3.76 billion (33 percent of GDP) at end-2020, comprising two thirds of multilateral and bilateral concessional loans and the rest in commercial terms. Malawi had arrears to Spain and a non-official/commercial creditor at the end of 2020. The authorities have been engaged in good faith negotiations in 2021 with both creditors (Spain and TDB) and repayments have started based on agreed rescheduling: (i) repayments to Spain started in May 2021 and will continue to November 2023; and (ii) the authorities met their debt obligations to TBD up to April 2022. (Text Table 2). The WB and IMF staffs received confirmation from the authorities that Malawi is current on all its external and domestic debt obligations, while there is no pending debt restructuring.

6. **Moreover, near-term debt service is highly concentrated on non-official / commercial creditors.** The downward revision to growth outlook and new external borrowings during 2018-20 have put pressure on debt service, though some of this pressure was alleviated as the debt relief became available from the Catastrophe Containment and Relief Trust (CCRT) and the G20 Debt Service Suspension Initiative (DSSI).[9] Terms of borrowing from non-official sources are highly non-concessional (¶19). As a result, near-term debt service is majority to non-official creditors; 79 percent and 72 percent of total debt service in 2021 and 2022, respectively (Text Table 3).

[9] The DSA and macro-framework assume CCRT debt service relief through April 2022 equivalent to about SDR 33 million. The last 3 months of debt service relief is subject to the availability of CCRT resources. The authorities are also participating in DSSI, and potential savings are estimated at US$1.15 million or 0.01 percent of GDP over the period May 2020 to December 2021.

Text Table 2. Malawi: External Debt, 2020

(Thousands of U.S. Dollars, unless otherwise indicated)

Creditor Type	Creditor Country/Multilateral Agency	2020	Percent of Total	Percent of GDP
Total External Debt 1/		**3,760.0**	**100.0**	**33.0**
Official multilateral		**2,214.8**	**58.9**	**19.4**
	African Dev. Bank	396.4	10.5	3.5
	International Monetary Fund	432.3	11.5	3.8
	World Bank-IDA	1,104.3	29.4	9.7
	Other Multilaterals	281.8	7.5	2.5
	o/w International Fund for Agricultural Development (IFAD)	88.9	2.4	0.8
	o/w OPEC Fund for International Development (OFID)	71.9	1.9	0.6
Official bilateral		**434.2**	**11.5**	**3.8**
	o/w China	219.0	5.8	1.9
	o/w India	136.0	3.6	1.2
	Spain (Arrears) 2/	8.2	0.2	0.1
Others		**1,111.0**	**29.5**	**9.7**
	o/w AFREXIM bank	757.0	20.1	6.6
	o/w Trade Development Bank (TDB)	145.0	3.9	1.3
	TDB (Arrears) 2/	209.0	5.6	1.8

Sources: Malawian Authorities; and IMF staff calculations.

1/ Debt stock on disbursement basis.

2/ For arrears that existed at the end of 2020, the authorities engaged on a good faith negotiation and agreed on a new repayment schedule in 2021.

Text Table 3. Malawi: External Debt Service, 2021-26

(Percent of total external debt service)

Creditor Type	Creditor Country/Multilateral Agency	Debt Service 2021	2022	2026
Total External Debt Service		**100.0**	**100.0**	**100.0**
Official multilateral		**12.6**	**19.5**	**78.5**
	AfDB, IMF, WB	7.8	15.4	67.2
	Other multilaterals	4.8	4.1	11.3
Official bilateral		**8.5**	**8.4**	**21.5**
	o/w China	4.5	4.5	11.3
	o/w India	2.9	2.8	7.2
Others		**78.9**	**72.1**	**0.0**
	o/w AFREXIM	58.5	53.4	0.0
	o/w TDB	8.6	7.8	0.0

Sources: The Malwian authorities; and IMF staff calculations.

7. External PPG debt has increased by a large margin in 2020, partly due to the conversion of the RBM's short-term reserve liabilities to medium-term debt. External PPG debt increased from 27.7 percent of GDP in 2019 to 33 percent of GDP in 2020. In 2012, the RBM started using a three-year revolving trade credit facility with a cap of $250 million to meet foreign exchange needs for strategic imports such as fuel and fertilizers. As exports of tobacco continued to stagnate, however, the RBM began to face difficulties in staying within the US$250 million cap and began to use forex swaps with domestic and RDBs.[10] As trade deficits continue to widen, the RBM faced difficulties in reversing currency swap open positions and staying within the cap of revolving trade credit facility. The RBM converted short-term currency swap open position to a medium-term forex facility of US$450 million at end June 2020, resulting in a sharp increase in external PPG debt.

UNDERLYING ASSUMPTIONS

8. The key macroeconomic assumptions have been updated from the DSA that accompanied the RCF request (the October 2020 DSA hereafter).[11] In the absence of policy adjustment under the baseline scenario, it is assumed that the authorities' fiscal and monetary policy stance will remain broadly status quo in the medium term, while mitigating the negative impact of COVID-19 predominantly in the near term: the fiscal domestic primary deficit will remain at about -3.2 percent of GDP; the reserve monetary growth will be anchored to achieve 6 percent by the end of the medium term; and the real effective exchange rate is projected to adjust by about 14 percent during the medium term. Changes to the underlying assumptions from the October 2020 DSA are as follows (Text Table 4):

Text Table 4. Malawi: Underlying DSA Assumptions

	Real GDP growth (percent)		Primary balance** (percent of GDP)		Total public debt** (percent of GDP)		Current account deficit (percent of GDP)		FDI (percent of GDP)	
Year	Previous	Current	Previous*	Current	Previous*	Current	Previous*	Current	Previous*	Current
2017	4.0	4.0	-0.6	-0.3	41.4	41.5	16.1	15.5	1.5	1.1
2018	3.2	4.4	-4.3	-2.7	59.7	43.9	14.9	12.0	1.6	1.1
2019	4.5	5.4	-2.7	-2.0	59.5	45.3	12.4	12.6	1.4	1.0
2020	0.6	0.9	-3.9	-2.7	69.2	54.8	14	13.6	1.1	0.8
2021	2.2	2.2	-7.2	-3.7	78.2	58.3	14.5	15	1.4	0.8
2022	6.5	3.5	-6.0	-6.5	81.0	62.7	13.5	14.3	1.5	1.3
2023	6.5	4.5	-5.0	-4.8	82.5	66.9	13	12.6	1.5	1.3
2024	6.3	4	-3.8	-4.2	83.2	72.0	12.5	10.8	1.6	1.3
2025	6.3	4	-2.2	-4	82.4	78.0	12	10.7	1.8	1.4
2026	6.0	4.1	-2.0	-4.2	81.4	83.6	11.7	10.4	1.9	1.4
Avg 2026- 40	5.6	5.4	-0.1	0.1	75.1	81.5	10.5	3.8	2.3	1.8

Sources: Malawian authorities and IMF staff calculations and projections.

* Previous is October 2020 DSA recalculated with rebased GDP.

** Fiscal data refers to fiscal year; e.g. 2021=FY2020/21

[10] Fuel imports were just under US$200 million in 2010 and 2020 but the volume has increased from 277 million liters to 325 million liters over ten years.

[11] See IMF Country Report No. 20/288, 2020. The relative to GDP ratios are calculated using rebased GDP.

- The ***real GDP growth*** projection for 2021 remains unchanged from the October 2020 DSA at 2.2 percent.[12] However, the real GDP growth ***path in the medium to long term*** has been revised down: by about 2 percentage points in the medium term and less in the long term. While improvements in agricultural productivity and the services sector will be important drivers of growth, this revised medium-term outlook depends critically on: (i) a sustained increase in public investment with strong fiscal multipliers of public investment; (ii) the maintenance of a fiscal deficit in the order 10 percent of GDP over the medium term (and external current account deficits of comparable size); and (iii) continued access to sizable and further growing RDBs financing as well as domestic borrowing to cover large financing gaps despite unsustainable debt (¶9). As a result, the debt burden will continue to grow, and it is projected to crowd out private investment and hinder medium-term economic prospects. The long-term outlook is predicated on the sustained increase in public investment leading to an increase in the economy's potential output. Continuing to depend on non-concessional loans from the RDBs however comes with risks (¶18).

- Pressure on ***inflation*** is emerging. Headline inflation has increased from 7.6 percent at end-2020 to 8.9 percent at end-September 2021 partly due to currency depreciation and its passthrough effect on non-food inflation; food inflation remains above 10 percent despite a good harvest. CPI inflation is projected at 10 percent at end-2021 and about 7 percent at the end of the medium term provided that the monetary policy stance will be well anchored.

- The ***exchange rate*** is projected to gradually adjust in real term in the medium term. Unlike the current baseline, no REER adjustment was assumed under the second RCF. The nominal exchange rate has been kept stable since 2016 and has contributed to appreciating the currency by about 30 percent in real terms. The RBM has been allowing for greater flexibility in the nominal exchange rate since the summer 2020 but only gradually and it has continued to appreciate in real term. The baseline assumes that the real effective exchange rate (REER) will adjust by about half of the appreciation observed since 2016 in the next five years.

- The ***fiscal primary deficit*** has been revised to reflect the expansionary fiscal stance in the near term which peaks to 6.5 percent of GDP in 2022 and an average of 5 percent in the medium term (2021-25), as the current government is committed to maintain a minimum level of capital expenditure to support its developmental needs. Beyond the medium term, the fiscal program is anchored around the debt stabilizing primary balance as informed by the DSA and expressed in the authorities commitment to retore debt sustainability, as such the DSA assumes a fiscal primary surplus of 0.1 percent of GDP, on average over the period 2026-41. In the October 2020 DSA, however, primary balance was assumed to adjust under the 2018 ECF in place at the time.

[12] The National Statistics Office (NSO) has rebased GDP from 2010 to 2017. Post-rebasing, the preliminary GDP estimate for 2020 by the NSO and the Ministry of Economic Planning indicates that real GDP growth declined from 5.4 percent in 2019 to 0.9 percent in 2020 due to adverse impact of the pandemic on the economy especially on the service sector. The growth for 2021 is however projected rebound at 2.2 percent due to good harvest.

- The ***current account deficit*** has been revised to 15 percent in 2021 and is projected to decline in the medium term but only to about 10 percent of GDP as the fiscal deficits are projected to remain at about 10 percent of GDP. Staff projects a deterioration in service receipts (especially in hotel and transportation services). Over the medium term, the current account deficit is expected to remain high, which is consistent with the projection on fiscal. Exports are expected to increase by 2024 considering the resumption of tobacco exports to the United States, lifting the export ban on maize, and other export diversification efforts into other agricultural exports. The external sector assessment shows that Malawi's external sector position is substantially weaker than implied by fundamentals and desirable policies (2021 Article IV Consultation Staff Report).

- ***Gross official reserves*** were projected to increase from US$884 million (3.1 months of next year's imports) in 2020 to US$974 million (3.4 months of next year's imports) in 2021 in the October 2020 DSA. In this DSA, it is revised down from US$566 million (2.1 months of imports) in 2020 to US$394 million (1.4 months of next year's imports) in 2021 despite of emergency RCF assistance in 2020 and SDR allocation in 2021. Gross official reserves are expected to remain at about US$400-500 million (1½ months of imports) through 2026 under the assumption that the financing gap of about 20 percent of GDP during the medium term (2021-26) will be met with external financing from the RDBs as in the past (see below).

9. The assumption for the financing mix and borrowing terms are in line with the Malawi's Medium-Term Debt Management Strategy (MTDS) which aims to gradually reduce short-term debt. The financing mix assumptions are as follows:

- ***External borrowing***. The baseline assumes: (i) all the project loans ratified but undisbursed (US$1.32 billion as of end-June 2021) will be disbursed during the medium term; and (ii) additional loans (US$2.6 billion) will be contracted from RDBs to fill the financing gaps during the medium term. The baseline also assumes that IDA19 disbursement for FY22 will remain in line with FY21 outturn. In total, new external borrowing of $3.9 billion in the medium term (2021-26) which is significantly higher than the October 2020 DSA ($1.27 billion). The average grant element of new borrowing is projected to become significantly low over the medium term (about 40 percent at the time of the October 2020 DSA). The main reason for the decline in the grant element is its dependency on RDBs which have been lending at annual percentage rate (APR) of about 7-8 percent and have been filling the financing gap in the absence of donor support. The APR of 8 percent is assumed for the new borrowing.

- ***Domestic borrowing***. The baseline assumes the remaining financing gap will be picked up by domestic bank and nonbank institutions. Given the size of fiscal deficits that the authorities are planning to maintain, domestic borrowing averages about 9 percent of GDP each year during the medium term (which is higher than the size of bond purchases by banks observed in the past). The interest rate for 3-year bond and 10-year bond are assumed at 11.5 percent and 17 percent respectively. New bond issuance will move gradually towards longer maturity bonds, the share of bonds with a maturity greater than 7 years is expected to increase from 5% of new issuance to 20% by 2032.

REALISM OF THE BASELINE ASSUMPTIONS

10. The realism tools suggest that the baseline scenario is credible compared to Malawi's historical experience and cross-country experiences (Figures 3 and 4).

- The left-hand side panels of Figure 3 show the ***evolution*** of projections of external and public debt to GDP ratios for the current DSA, the previous DSA (the October 2020 DSA), and the DSA from 5 years ago. The current DSA reflects the latest revisions to the medium-term outlook and policy direction of the authorities in presence of COVID-19 shock and the need of development spending to achieve the goals of the Malawi Vision 2063. The difference between the current DSA and the previous DSA is large for the reasons discussed above (¶5).

- ***Debt-creating flows*** charts (middle panel) show that the important contribution of the nominal interest rate over the 5-year projected change, reflecting the compositional changes in the external debt (¶4).

- The ***unexpected*** increases in PPG external debt and public debt (right-hand side panels of Figure 3) are about 14.7 and 28 percent of GDP, respectively, which are both above the median of the countries producing LIC DSF. The drivers of the unexpected public debt accumulation are unexpected increase in primary deficits and unexpected depreciation of the real exchange rate.

11. Modest improvements in the primary balance in the next three years is in the middle of historical data on LIC adjustment programs (Figure 4). The second DSF realism tool assesses the realism of the fiscal projection. The top-left panel of Figure 4 highlights that the anticipated adjustment in the primary balance of 0.5 percentage points of GDP is in line with other LICs. The top-right panel of Figure 4 shows that growth projection for 2021 and 2022 are optimistic relative to what is suggested by the fiscal multiplier realism tool. This is because of the economic rebound that is expected after the attenuation of the negative impact of COVID-19 shock. The bottom two panels reflect the authorities' plan to ramp up public investment to generate growth.

COUNTRY CLASSIFICATION AND MODEL SIGNAL

12. Malawi's debt-carrying capacity based on the Composite Indicator (CI) is assessed as weak (Text Table 5).[13] The CI is determined by the World Bank's CPIA and other variables informed by the macroeconomic framework, such as real GDP growth, import coverage of reserves, remittances as percent of GDP, and growth of the world economy. Malawi's CI based on the current vintage (2021 CPIA) has been downgraded to 'weak' with a CI score of 2.56 compared to 'medium' CI score of 2.84 under the DSA presented in the context of Malawi's request for RCF on October 2020. In addition, Malawi is classified as

[13] The CI captures the impact of the different factors through a weighted average of the World Bank's 2020 Country Policy and Institutional Assessment (CPIA) score, the country's real GDP growth, remittances, international reserves, and world growth. A country's debt-carrying capacity would be assessed as weak if its CI value is below 2.69, medium if it lies between 2.69 and 3.05, and strong if it is above 3.05. Malawi's debt-carrying capacity based on the CI, which is based on the October 2021 WEO and the 2020 CPIA, is assessed as weak. The CI score is 2.56.

"weak quality of debt monitoring" in line with the country's debt-recording capacity. The four external debt burden thresholds and the total public debt benchmark are determined by this classification of the debt carrying capacity (Text Figure 6).

Text Table 5. Malawi: Composite Index

Debt Carrying Capacity	Weak

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Weak	Weak 2.56	Weak 2.57	Weak 2.51

Malawi : Request for Disbursement Under the Rapid Credit Facility-Press Release; Staff Report; and Statement by the Executive Director for Malawi (imf.org)

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.196	1.23	48%
Real growth rate (in percent)	2.719	3.772	0.10	4%
Import coverage of reserves (in percent)	4.052	25.387	1.03	40%
Import coverage of reserves^2 (in percent)	-3.990	6.445	-0.26	-10%
Remittances (in percent)	2.022	1.465	0.03	1%
World economic growth (in percent)	13.520	3.137	0.42	17%
CI Score			2.56	100%
CI rating			Weak	

Text Table 6. Malawi: Debt Carrying Capacity and Thresholds

EXTERNAL debt burden thresholds	Weak	Medium	Strong
PV of debt in % of			
Exports	140	180	240
GDP	30	40	55
Debt service in % of			
Exports	10	15	21
Revenue	14	18	23

EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	140
GDP	30
Debt service in % of	
Exports	10
Revenue	14

TOTAL public debt benchmark	
PV of total public debt in percent of GDP	35

SCENARIO STRESS TESTS

13. Standard scenarios stress test and a contingent liability stress test are conducted (Text Table 7, and Tables 3 and 4). A stress test combined contingent liabilities of a one-time debt shock (equivalent to 9 percent of GDP) in 2021, to capture the potential impact of limited public debt coverage (2 percent of GDP, instead of the default level of zero) and contingent liabilities from SOEs[14] (equivalent to 2 percent of GDP) and the need to for bank recapitalization.[15]

14. A second tailored scenario presented is a commodity price shock (Tables 3 and 4). Given the high share of Malawi's tobacco exports in total exports (goods and services) of more than 50 percent over the previous three-year period, the DSA also conducts a stress test where commodity exports are shocked by a commodity price gap in the second year of projection, which converges to the baseline in 6 years.[16] A decline in exports to a level equivalent to one standard deviation below their historical average in the second and third years of the projection period would cause the PV of debt-to-exports ratio and PV of debt-to-GDP to rise and remain elevated exceeding the baseline projections over the medium term.

Text Table 7. Malawi: Public Debt Coverage and Magnitude of the Contingent Liability Tailored Stress Test

Public debt coverage and the magnitude of the contingent liability tailored stress test

B. Please customize elements of the contingent liability tailored test, as applicable.

1 The country's coverage of public debt	The central government, central bank, government-guaranteed debt			
	Default	Used for the analysis	Reasons for deviations from the default settings
2 Other elements of the general government not captured in 1.	0 percent of GDP	2	Limited coverage
3 SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2	
4 PPP	35 percent of PPP stock	0.00	
5 Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5	
Total (2+3+4+5) (in percent of GDP)	9.0		

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%.

[14] The SOE external liability is identified based on a Fund staff survey conducted in 2016.

[15] The need for bank recapitalization is equivalent to the default level of 5 percent of GDP to the average cost to the government of a financial crisis in a low-income country since 1980.

[16] The price gap is defined as the difference between the baseline commodity price in the second year of projection and the lower end of the 68 percent confidence interval from the IMF's commodity price forecast distribution for fuel and non-fuel commodities which may be found at IMF Primary Commodity Prices. The size and duration of these responses were informed by the analysis of episodes of commodity price busts in a sample of 34 commodity-intensive LICs during 1990-2015. The elasticities are within the range of estimates found in the literature (e.g., Spatafora ad Samake, 2012. "Commodity Price Shocks and Fiscal Outcomes," IMF Working Paper No. 12/112; and Cespedes and Velasco, 2013. "Was This Time Different? Fiscal Policy in Commodity Republics," NBER Working Paper No. 19748).

EXTERNAL DSA

15. Malawi's external and public debt is assessed to be in high risk of debt distress and granularity in risk rating assess that public debt under current policies is unsustainable. The arrears to the TDB and Spain at the end of 2020 have been rescheduled and payments have started on an agreed scheduled. Under the baseline, the external DSA assesses that Malawi's external debt is high because there are large and protracted threshold breaches on a number of external debt stock and external debt service burden indicators (both external debt-service to exports ratio and external debt-service to revenue ratios). One of the stock indicators, the PV debt to GDP ratio, stay below the threshold during the medium to long term, but the other indicator, the PV debt to export ratio, only become below the threshold after the medium term. These indicators all point to significant pressure on servicing the external debt in the medium to long term.

16. The stress scenarios highlight Malawi's debt is vulnerable to any shocks in exports, the exchange rate and non-debt flows such as aid flows. The historical scenario, which assumes that real GDP growth, the primary balance-to-GDP ratio, the GDP deflator, the non-interest current account, and net FDI flows permanently remain at their historical averages, indicates that the baseline is in line with the historical pattern. Various stress test scenarios presented in Figure 1 show that Malawi's debt is vulnerable to shocks in exports (see the PV debt to export ratio and the debt service to export ratio), those in the exchange rate (see the debt service to revenue ratio), and those in non-debt flows (see the PV debt to GDP ratio).

PUBLIC DSA

17. Malawi's overall public debt is assessed to be high and unsustainable under current policies, as external debt is unsustainable and the PV of public debt-to-GDP ratio remains above the threshold and other indicators do not stabilize over time. Total public debt is projected to rise from medium to long term in the baseline scenario. Unlike the historical scenario under which public debt indicators gradually decline to threshold level in the long term, all three public debt burden indicators are above their indicative thresholds under the baseline (Figure 2). The PV of debt-to-GDP ratio reaches 80 percent by 2031 and the debt to revenue ratio and the debt service to revenue ratio grow to reach 500 percent and 135 percent, respectively. These numbers point to the severity of the debt burden on the economy. There are many factors contributing to the situation, Malawi's inability to sustain growth, partly due to frequent weather-related shocks; high cost of sovereign borrowing (e.g., the most recent infrastructure bond issuances in August 2021 was priced at 23 percent); and the high level of existing debt with a large fraction being on non-concessional term.

RISK RATING AND VULNERABILITIES

18. Malawi's external and public debt is at high risk of debt distress and granularity in risk rating assesses that public debt under current policies is unsustainable. The assessment reflects the significant debt vulnerabilities emanating from the large and protracted threshold breaches on a number of debt stock and debt service burden indicators. Malawi's exposure to financing risks is significant. The WB and IMF Staff assess the main risk to the baseline is a sudden stop of available financing especially from RDBs. If this risk materializes, an abrupt forced adjustment with a significant impact on growth, financial stability and the most vulnerable population becomes inevitable. Additional risks to the ratings assessment arise from weaker-than expected policy implementation, fiscal slippage, macroeconomic uncertainty (especially from weather shocks), tighter global financial conditions, increase of essential imports costs and a weak and diverging global economic recovery which could depress export growth. Authorities are continuing to implement improvements in tax administration, which will help with compliance and revenue collection going forward.

19. Containing Malawi's debt vulnerabilities requires policy adjustment to address macroeconomic imbalances and upfront actions to return to moderate risk of debt distress with a sustainable path. Over the medium term, a strong fiscal adjustment program is needed to stabilize the public debt. Redoubling efforts on domestic revenue mobilization, reprioritizing expenditure through curtailing growth in wages while safeguarding capital spending, reforming the Affordable Input Program (AIP) and goods and services; and reducing non-critical spending would help in this regard. Realism in budget forecasts and public financial management (PFM) reforms would help containing fiscal deficits and debt. This needs to be supported by strengthening public sector governance and institutions to help safeguard scarce resources and strengthen policy effectiveness. In addition, given how Malawi's external position is assessed to be substantially weaker than the level implied by economic fundamentals and desirable policies, allowing for greater flexibility in the exchange rate, containing external imbalances, and rebuilding reserves are critical in reducing Malawi's vulnerabilities to external shocks. This should be supported by a well-functioning and transparent foreign exchange interbank market and a foreign exchange reserve management strategy. On the latter, the authorities need to promptly address data shortcoming related to reserves, especially the possible inclusion of encumbered assets that inflate reported reserves.

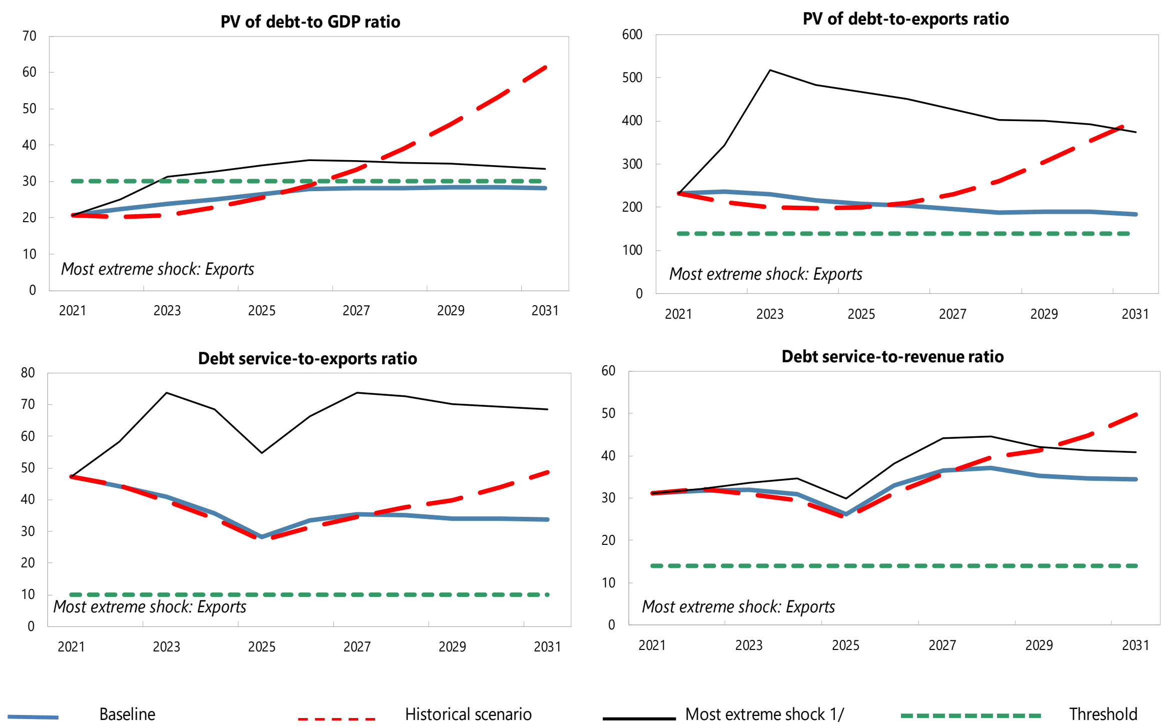
20. Malawi also needs significant structural reforms to support sustained inclusive growth in the medium to long term. Promoting diversification and commercialization in the agriculture sector will be key to increasing incomes and strengthening resilience. The government needs to rebalance spending in the agriculture sector away from fiscally unsustainable maize input subsidies and toward investments that promote diversification and growth. Subsidy programs need to be affordable, more cost-efficient, and should reduce fiscal risks. In addition, commercializing agriculture requires predictable and transparent trade policies. As such, a sound implementation and monitoring framework of trade measures under the Control of Goods Act would help safeguard food security and balance this with increasing export potential, as well as development of various value chains. As part of this, the rules for the implementation of export mandate regulations should be assessed in consultation with the private sector to avoid creating additional market distortions. A reliable, transparent trade policy would, in turn, stimulate investment and commercialization, which could increase production, food security, and exports in the medium term. The Agricultural Development and Marketing Corporation's (ADMARC's) market interventions also need to be transparent, timely, and predictable.

21. **Policies to increase diversification outside of agriculture will also be critical to enhance productivity, value addition, and job creation**. Key to this will be expanding reliable access to electricity, which calls for continued progress on energy investment projects and stronger governance at key sector utilities. In addition, the Government should reform tax policies and administration and business regulations, to increase transparency, reduce ad hoc changes, and support value addition. The government can harness growth in the mobile and Information Communication Technology (ICT) sectors by reviewing the tax regime, levies, and tariffs to enable greater customer access; and fostering competition in the broadband infrastructure development market. Finally, reducing Government domestic borrowing will ease pressures on interest rates, enabling broader access to finance for Small and Medium-Sized Enterprises (SMEs).

AUTHORITIES' VIEWS

22. **The authorities are in broad agreement with the WB's and IMF's staff assessments**. They are undertaking policy action to address debt sustainability through engagement with creditors, including RDBs for rescheduling existing debt. Authorities are also engaging with traditional and nontraditional donors for possible voluntary debt buy back schemes to offset more expensive debt.

Figure 1. Malawi: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2021–31



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

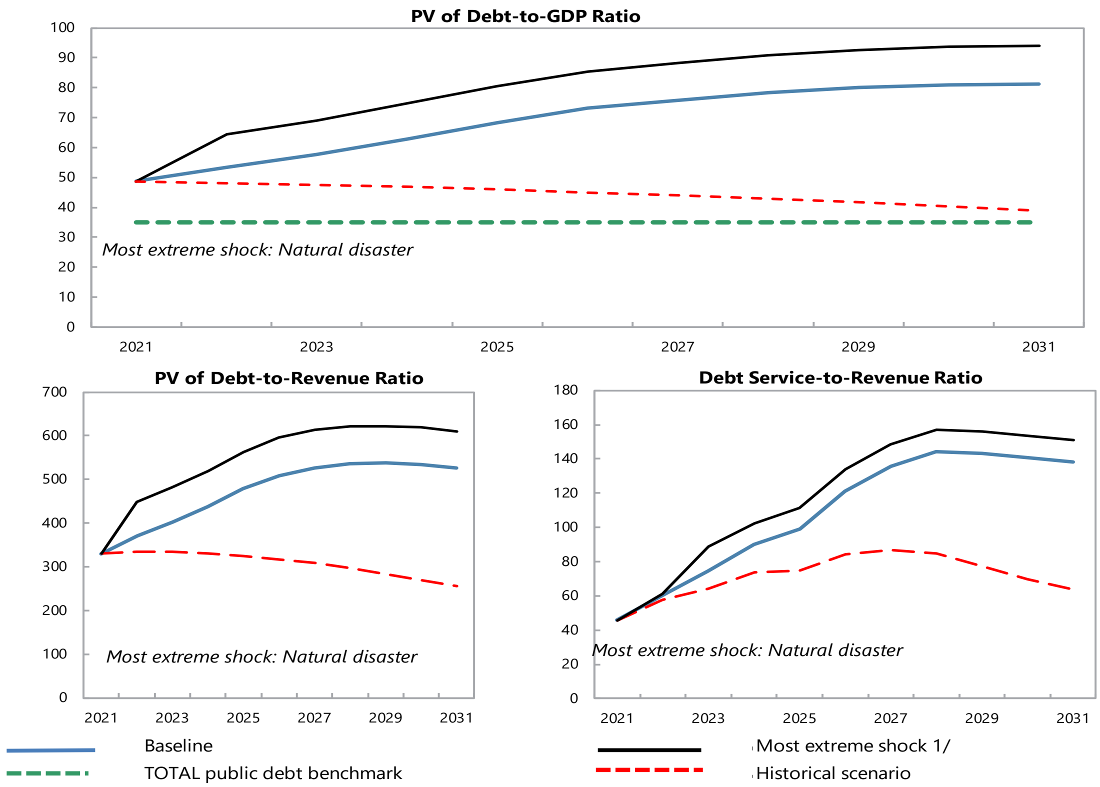
Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

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	5.8%	5.8%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	14	14
Avg. grace period	3	3

* 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 2031. 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. Malawi: Indicators of Public Debt Under Alternative Scenarios, FY2021–31



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	30%	30%
Domestic medium and long-term	60%	60%
Domestic short-term	11%	11%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	5.8%	5.8%
Avg. maturity (incl. grace period)	14	14
Avg. grace period	3	3
Domestic MLT debt		
Avg. real interest rate on new borrowing	7.0%	3.0%
Avg. maturity (incl. grace period)	4	10
Avg. grace period	1	1
Domestic short-term debt		
Avg. real interest rate	5.9%	5.9%

* 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.

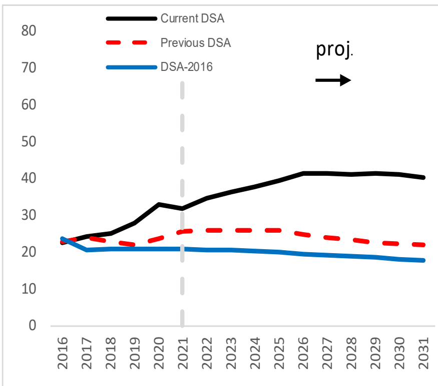
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. 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.

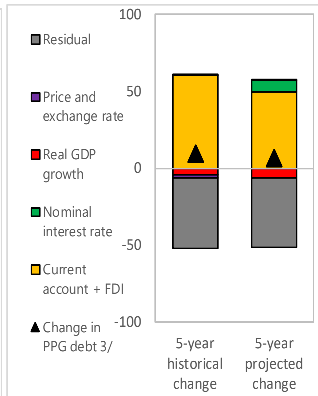
Figure 3. Malawi: Drivers of Debt Dynamics – Baseline Scenario

External debt

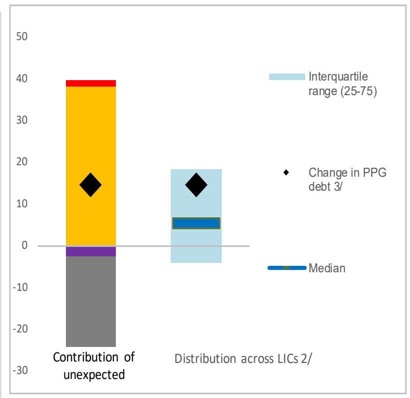
Gross Nominal PPG External Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)

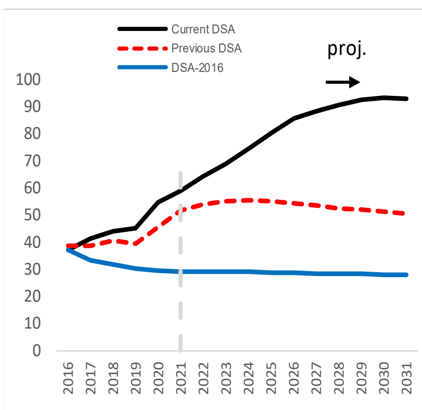


Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)

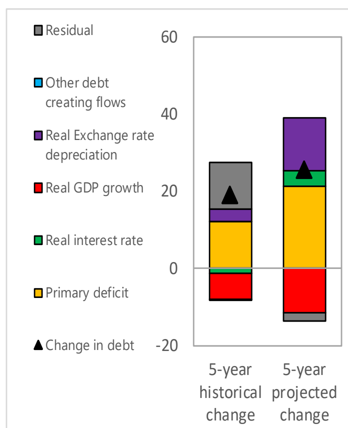


Public debt

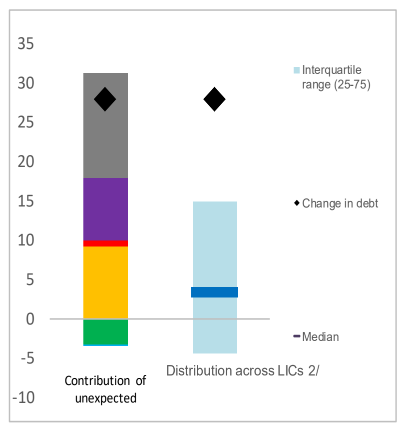
Gross Nominal Public Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)



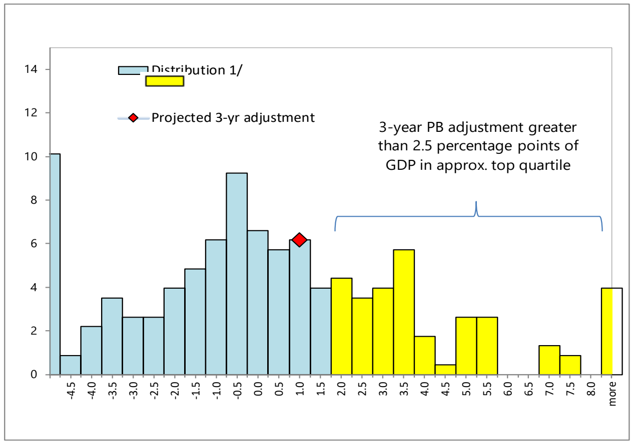
Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)



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.

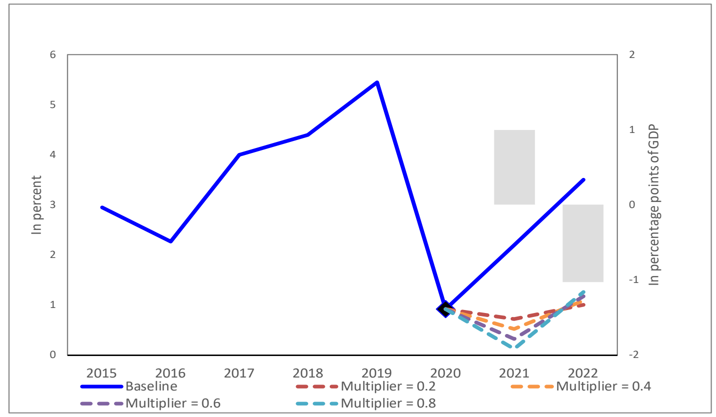
Figure 4. Malawi: Realism Tools

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



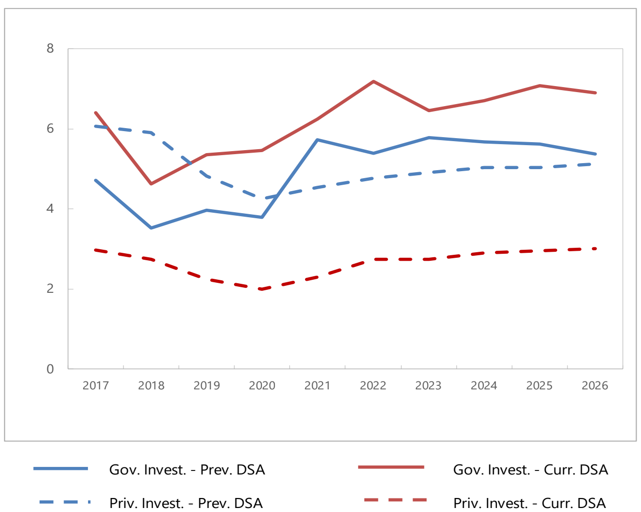
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

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)

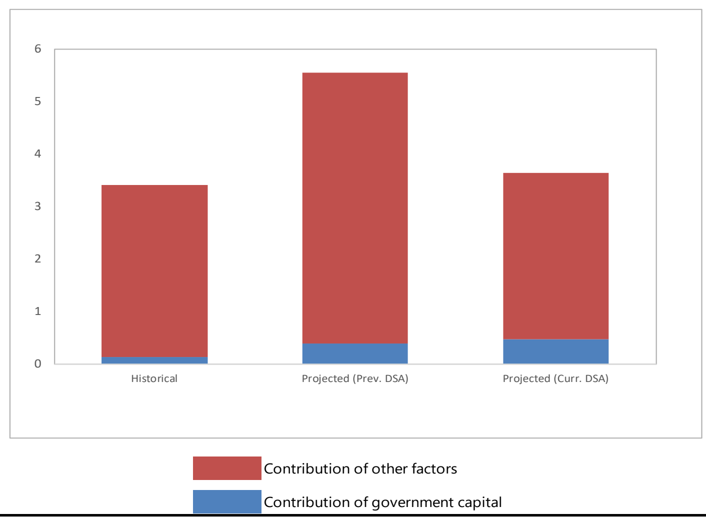
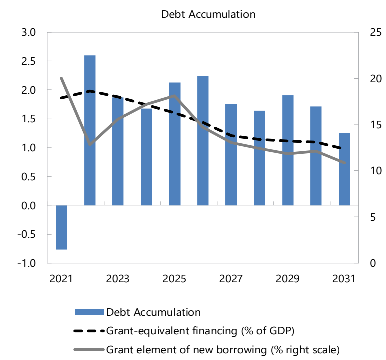


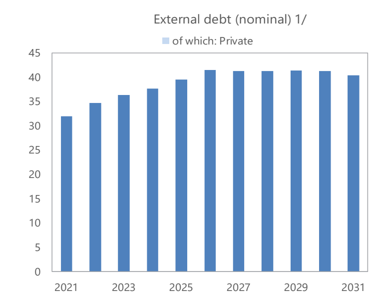
Table 1. Malawi: External Debt Sustainability Framework, Baseline Scenario, FY 2018–41

(Percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projections
External debt (nominal) 1/	25.0	27.8	32.9	31.9	34.7	36.3	37.6	39.5	41.5	40.3	23.8	22.5	38.8
of which: public and publicly guaranteed (PPG)	25.0	27.8	32.9	31.9	34.7	36.3	37.6	39.5	41.5	40.3	23.8	22.5	38.8
Change in external debt	0.8	2.9	5.1	-1.0	2.8	1.6	1.4	1.9	1.9	-0.9	-0.6		
Identified net debt-creating flows	8.7	9.0	10.9	13.5	11.9	9.8	8.1	7.9	7.4	0.9	-1.9	8.6	6.7
Non-interest current account deficit	11.8	12.4	13.4	13.7	12.7	10.9	8.9	9.2	8.7	3.4	-0.9	10.2	8.2
Deficit in balance of goods and services	16.1	16.7	17.6	17.6	16.7	15.0	13.2	13.5	13.1	7.9	2.4	13.3	12.5
Exports	11.3	10.8	8.2	8.9	9.5	10.4	11.6	12.7	13.7	15.3	15.4		
Imports	27.3	27.6	25.8	26.5	26.2	25.4	24.8	26.3	26.7	23.3	17.7		
Net current transfers (negative = inflow)	-5.7	-5.8	-5.6	-5.3	-5.4	-5.6	-5.7	-5.8	-5.8	-6.0	-3.1	-4.6	-5.7
of which: official	0.0	-0.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other current account flows (negative = net inflow)	1.4	1.5	1.3	1.4	1.4	1.4	1.4	1.5	1.5	1.5	-0.2	1.4	1.4
Net FDI (negative = inflow)	-1.1	-1.0	-0.8	-0.8	-1.3	-1.3	-1.3	-1.4	-1.4	-1.8	-1.9	-1.2	-1.4
Endogenous debt dynamics 2/	-2.1	-2.5	-1.7	0.6	0.4	0.2	0.4	0.0	0.1	-0.7	0.9		
Contribution from nominal interest rate	0.2	0.2	0.2	1.3	1.5	1.7	1.9	1.5	1.7	1.4	0.9		
Contribution from real GDP growth	-1.0	-1.2	-0.2	-0.7	-1.1	-1.5	-1.4	-1.5	-1.6	-2.1	0.0		
Contribution from price and exchange rate changes	-1.3	-1.4	-1.7	...	...	...	...	...	...	...	...		
Residual 3/	-7.9	-6.1	-5.8	-14.5	-9.1	-8.2	-6.7	-6.0	-5.4	-1.8	1.3	-6.2	-6.1
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	...	...	21.9	20.7	22.4	23.8	25.0	26.5	27.9	28.1	16.9		
PV of PPG external debt-to-exports ratio	...	...	269.1	232.7	235.7	229.7	215.1	208.4	203.8	183.4	109.9		
PPG debt service-to-exports ratio	5.7	5.5	7.2	47.2	44.1	40.8	35.7	28.1	33.3	33.7	24.2		
PPG debt service-to-revenue ratio	4.5	4.6	4.6	31.1	31.8	31.9	31.0	26.3	33.1	34.4	28.8		
Gross external financing need (Billion of U.S. dollars)	1.1	1.3	1.6	2.1	2.0	1.8	1.5	1.5	1.6	1.2	0.3		
Key macroeconomic assumptions													
Real GDP growth (in percent)	4.4	5.4	0.9	2.2	3.5	4.5	4.0	4.0	4.1	5.5	0.0	3.8	4.5
GDP deflator in US dollar terms (change in percent)	5.9	5.9	6.4	0.0	0.4	-2.2	-2.0	-1.6	-1.0	0.2	0.0	-0.9	-0.5
Effective interest rate (percent) 4/	1.0	0.9	0.7	4.1	5.0	5.0	5.3	4.0	4.5	3.7	3.7	0.8	4.4
Growth of exports of G&S (US dollar terms, in percent)	5.6	7.6	-19.2	11.6	11.1	11.2	14.3	12.0	10.9	7.7	-2.3	-2.4	10.2
Growth of imports of G&S (US dollar terms, in percent)	-2.1	12.8	0.3	5.1	2.8	-1.1	-0.4	8.4	4.9	2.2	0.0	2.5	3.1
Grant element of new public sector borrowing (in percent)	...	...	...	20.0	12.8	15.6	17.2	18.1	14.7	10.9	0.0	...	14.4
Government revenues (excluding grants, in percent of GDP)	14.1	13.1	12.8	13.5	13.2	13.2	13.4	13.6	13.8	15.0	12.9	12.9	13.9
Aid flows (in Billion of US dollars) 5/	0.2	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.1		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.9	2.0	1.9	1.7	1.6	1.4	1.0	0.4	...	1.5
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	43.6	26.5	30.1	31.5	28.2	22.1	17.7	15.8	...	24.9
Nominal GDP (Billion of US dollars)	10	11	12	12	13	13	13	13	14	18	32		
Nominal dollar GDP growth	10.5	11.6	7.4	2.2	3.9	2.2	1.9	2.3	3.0	5.7	0.0	2.9	4.0
Memorandum items:													
PV of external debt 7/	...	...	21.9	20.7	22.4	23.8	25.0	26.5	27.9	28.1	16.9		
In percent of exports	...	...	269.1	232.7	235.7	229.7	215.1	208.4	203.8	183.4	109.9		
Total external debt service-to-exports ratio	5.7	5.5	7.2	47.2	44.1	40.8	35.7	28.1	33.3	33.7	24.2		
PV of PPG external debt (in Billion of US dollars)			2.6	2.5	2.8	3.1	3.3	3.6	3.9	5.1	5.4		
(PVt-PVt-1)/GDPt-1 (in percent)				-0.8	2.6	1.9	1.7	2.1	2.2	1.3	-0.3		
Non-interest current account deficit that stabilizes debt ratio	11.1	9.5	8.3	14.7	9.9	9.3	7.6	7.4	6.7	4.3	-0.3		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes





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) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

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.

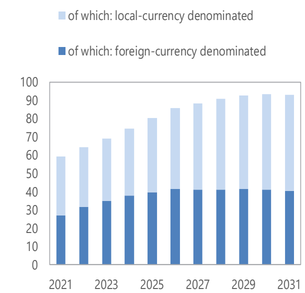
Table 2. Malawi: Public Sector Debt Sustainability Framework, Baseline Scenario, FY2018–41

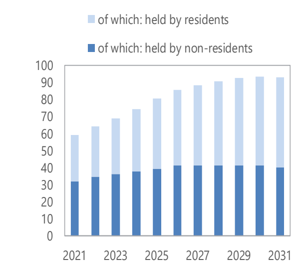
(Percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projections
Public sector debt 1/	**43.9**	**45.3**	**54.8**	**59.0**	**64.3**	**68.9**	**74.4**	**80.4**	**85.7**	**92.8**	**69.4**	**37.6**	**80.9**
of which: external debt	**25.0**	**27.8**	**32.9**	**31.9**	**34.7**	**36.3**	**37.6**	**39.5**	**41.5**	**40.3**	**23.8**	**22.5**	**38.8**
Change in public sector debt	2.4	1.4	9.5	4.2	5.2	4.6	5.5	6.0	5.3	-0.4	2.6		
Identified debt-creating flows	**0.6**	**0.0**	**7.1**	**3.0**	**2.6**	**1.9**	**2.9**	**3.7**	**3.2**	**-2.0**	**2.6**	**1.5**	**1.6**
Primary deficit	**1.6**	**1.5**	**5.0**	**4.0**	**5.0**	**4.2**	**3.9**	**4.3**	**3.2**	**-0.1**	**-2.2**	**1.7**	**2.6**
Revenue and grants	15.0	14.8	14.5	14.7	14.4	14.3	14.3	14.3	14.3	15.4	13.3	**15.4**	**14.6**
of which: grants	0.9	1.7	1.8	1.3	1.2	1.1	1.0	0.7	0.6	0.4	0.4		
Primary (noninterest) expenditure	16.6	16.3	19.5	18.7	19.4	18.5	18.3	18.5	17.5	15.3	11.1	**17.1**	**17.2**
Automatic debt dynamics	**-1.0**	**-1.5**	**2.1**	**-1.0**	**-2.4**	**-2.3**	**-1.1**	**-0.6**	**0.0**	**-1.8**	**4.8**		
Contribution from interest rate/growth differential	-1.1	-1.7	1.3	-1.0	-2.4	-2.3	-1.1	-0.6	0.0	-1.8	4.8		
of which: contribution from average real interest rate	0.7	0.5	1.7	0.2	-0.4	0.5	1.6	2.3	3.2	3.0	4.8		
of which: contribution from real GDP growth	-1.7	-2.3	-0.4	-1.2	-2.0	-2.8	-2.7	-2.9	-3.2	-4.9	0.0		
Contribution from real exchange rate depreciation	0.0	0.2	0.8	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
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	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**1.8**	**1.4**	**2.4**	**1.3**	**2.6**	**2.8**	**2.6**	**2.3**	**2.1**	**1.6**	**0.0**	**2.1**	**1.9**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**44.6**	**48.6**	**53.3**	**57.6**	**62.8**	**68.3**	**73.1**	**81.1**	**62.8**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**306.7**	**329.7**	**370.8**	**402.6**	**437.9**	**478.3**	**509.4**	**526.3**	**471.8**		
Debt service-to-revenue and grants ratio 3/	**26.7**	**26.7**	**24.9**	**45.9**	**60.2**	**74.5**	**89.9**	**98.8**	**121.1**	**138.3**	**127.9**		
Gross financing need 4/	5.6	5.4	8.6	10.8	13.7	14.9	16.8	18.4	20.6	21.2	14.9		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	4.4	5.4	0.9	2.2	3.5	4.5	4.0	4.0	4.1	5.5	0.0	**3.8**	**4.5**
Average nominal interest rate on external debt (in percent)	1.0	0.9	0.7	4.2	5.1	5.3	5.5	4.2	4.6	3.8	3.8	**0.9**	**4.6**
Average real interest rate on domestic debt (in percent)	9.5	8.7	11.5	3.4	2.7	4.8	6.8	8.6	9.3	6.6	9.1	**4.7**	**7.3**
Real exchange rate depreciation (in percent, + indicates depreciation)	0.2	1.0	4.0	...	...	...	...	...	...	...	...	**20.7**	**...**
Inflation rate (GDP deflator, in percent)	6.1	7.7	6.3	7.8	10.6	9.0	7.5	6.4	6.0	4.4	0.0	**15.5**	**6.4**
Growth of real primary spending (deflated by GDP deflator, in percent)	-4.7	3.1	21.2	-1.9	7.1	-0.4	2.8	5.4	-1.5	3.6	0.0	**5.1**	**2.3**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-0.8	0.1	-4.5	-0.3	-0.2	-0.5	-1.6	-1.7	-2.1	0.2	-4.8	**-1.7**	**-0.8**
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	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt . Definition of external debt is Residency-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.

Table 3. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, FY2021–31

(Percent)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of debt-to GDP ratio											
Baseline	21	22	24	25	26	28	28	28	28	28	28
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	21	20	21	23	25	29	**33**	**39**	**46**	**53**	**61**
B. Bound Tests											
B1. Real GDP growth	21	23	25	26	28	29	30	30	30	30	30
B2. Primary balance	21	23	25	26	28	29	29	29	30	30	29
B3. Exports	21	25	**31**	**33**	**34**	**36**	**36**	**35**	**35**	**34**	**33**
B4. Other flows 3/	21	25	30	**31**	**33**	**34**	**34**	**33**	**33**	**33**	**32**
B5. Depreciation	21	27	22	23	25	26	27	28	29	29	30
B6. Combination of B1-B5	21	27	28	30	**32**	**33**	**33**	**33**	**32**	**32**	**32**
C. Tailored Tests											
C1. Combined contingent liabilities	21	25	27	28	**30**	**32**	**32**	**32**	**33**	**33**	**33**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	21	24	26	27	29	30	30	29	29	29	28
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	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	**233**	**236**	**230**	**215**	**208**	**204**	**196**	**188**	**190**	**189**	**183**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**233**	**212**	**200**	**198**	**200**	**210**	**231**	**260**	**306**	**354**	**401**
B. Bound Tests											
B1. Real GDP growth	**233**	**236**	**230**	**215**	**208**	**204**	**196**	**188**	**190**	**189**	**183**
B2. Primary balance	**233**	**240**	**238**	**224**	**217**	**212**	**204**	**196**	**197**	**197**	**191**
B3. Exports	**233**	**344**	**518**	**484**	**466**	**451**	**426**	**403**	**399**	**392**	**374**
B4. Other flows 3/	**233**	**265**	**286**	**267**	**258**	**249**	**236**	**223**	**222**	**218**	**209**
B5. Depreciation	**233**	**224**	**165**	**156**	**152**	**151**	**149**	**147**	**152**	**155**	**153**
B6. Combination of B1-B5	**233**	**332**	**263**	**369**	**357**	**345**	**328**	**312**	**312**	**308**	**296**
C. Tailored Tests											
C1. Combined contingent liabilities	**233**	**264**	**260**	**245**	**238**	**233**	**225**	**217**	**220**	**220**	**214**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**233**	**275**	**273**	**249**	**234**	**223**	**208**	**196**	**195**	**192**	**184**
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	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	**47**	**44**	**41**	**36**	**28**	**33**	**35**	**35**	**34**	**34**	**34**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**47**	**45**	**40**	**34**	**27**	**31**	**35**	**38**	**40**	**44**	**49**
B. Bound Tests											
B1. Real GDP growth	**47**	**44**	**41**	**36**	**28**	**33**	**35**	**35**	**34**	**34**	**34**
B2. Primary balance	**47**	**44**	**41**	**36**	**29**	**34**	**36**	**36**	**35**	**35**	**35**
B3. Exports	**47**	**58**	**74**	**69**	**55**	**66**	**74**	**73**	**70**	**69**	**68**
B4. Other flows 3/	**47**	**44**	**42**	**39**	**31**	**38**	**41**	**40**	**39**	**39**	**38**
B5. Depreciation	**47**	**44**	**40**	**32**	**25**	**30**	**29**	**29**	**28**	**28**	**28**
B6. Combination of B1-B5	**47**	**54**	**64**	**56**	**45**	**55**	**58**	**57**	**55**	**55**	**55**
C. Tailored Tests											
C1. Combined contingent liabilities	**47**	**44**	**42**	**37**	**30**	**35**	**37**	**37**	**36**	**36**	**35**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**47**	**49**	**45**	**40**	**31**	**36**	**39**	**38**	**36**	**36**	**35**
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	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	**31**	**32**	**32**	**31**	**26**	**33**	**36**	**37**	**35**	**35**	**34**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**31**	**32**	**31**	**30**	**25**	**31**	**36**	**40**	**41**	**45**	**50**
B. Bound Tests											
B1. Real GDP growth	**31**	**33**	**34**	**33**	**28**	**35**	**38**	**39**	**37**	**36**	**36**
B2. Primary balance	**31**	**32**	**32**	**31**	**27**	**34**	**37**	**38**	**36**	**36**	**35**
B3. Exports	**31**	**32**	**34**	**35**	**30**	**38**	**44**	**44**	**42**	**41**	**41**
B4. Other flows 3/	**31**	**32**	**33**	**33**	**29**	**37**	**42**	**43**	**40**	**40**	**39**
B5. Depreciation	**31**	**40**	**40**	**36**	**30**	**37**	**38**	**39**	**37**	**36**	**37**
B6. Combination of B1-B5	**31**	**33**	**35**	**34**	**29**	**38**	**42**	**42**	**40**	**39**	**39**
C. Tailored Tests											
C1. Combined contingent liabilities	**31**	**32**	**33**	**32**	**28**	**35**	**38**	**39**	**37**	**36**	**36**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**31**	**35**	**36**	**36**	**30**	**37**	**40**	**40**	**37**	**36**	**36**
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	14	14	14	14	14	14	14	14	14	14	14

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. Malawi: Sensitivity Analysis for Key Indicators of Public Debt, FY2021–31
(Percent)

	Projections 1/										
	2021	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**
					PV of Debt-to-GDP Ratio						
Baseline	**49**	**53**	**58**	**63**	**68**	**73**	**76**	**78**	**80**	**81**	**81**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**49**	**48**	**48**	**47**	**46**	**45**	**44**	**43**	**42**	**40**	**39**
A2. Alternative Scenario :[Customize, enter title]	**48**	**49**	**50**	**51**	**52**	**53**	**55**	**57**	**59**	**60**	**61**
B. Bound Tests											
B1. Real GDP growth	**49**	**55**	**62**	**68**	**74**	**80**	**84**	**87**	**89**	**91**	**92**
B2. Primary balance	**49**	**55**	**61**	**66**	**71**	**76**	**79**	**81**	**83**	**84**	**84**
B3. Exports	**49**	**56**	**65**	**70**	**76**	**81**	**83**	**85**	**86**	**86**	**86**
B4. Other flows 3/	**49**	**56**	**64**	**69**	**75**	**79**	**82**	**84**	**85**	**85**	**85**
B5. Depreciation	**49**	**54**	**58**	**62**	**66**	**70**	**71**	**73**	**74**	**74**	**74**
B6. Combination of B1-B5	**49**	**53**	**57**	**62**	**67**	**72**	**75**	**78**	**80**	**80**	**81**
C. Tailored Tests											
C1. Combined contingent liabilities	**49**	**63**	**67**	**72**	**78**	**82**	**85**	**87**	**89**	**90**	**90**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**49**	**56**	**62**	**69**	**76**	**83**	**86**	**89**	**92**	**93**	**94**
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	35	35	35	35	35	35	35	35	35	35	35
					PV of Debt-to-Revenue Ratio						
Baseline	330	371	403	438	478	509	527	535	537	535	526
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	330	335	334	331	325	317	308	296	284	270	256
A2. Alternative Scenario :[Customize, enter title]	46	37	44	53	56	66	74	78	78	77	76
B. Bound Tests											
B1. Real GDP growth	330	383	431	473	520	558	581	594	600	601	596
B2. Primary balance	330	382	423	458	499	530	546	554	556	553	544
B3. Exports	330	388	453	489	531	562	575	579	576	569	557
B4. Other flows 3/	330	391	445	482	524	554	567	572	570	564	552
B5. Depreciation	330	380	404	432	463	487	497	500	498	492	482
B6. Combination of B1-B5	330	367	401	431	469	503	525	532	534	532	526
C. Tailored Tests											
C1. Combined contingent liabilities	330	435	467	503	543	575	590	597	597	593	583
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	330	420	470	524	569	600	611	611	616	617	611
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	46	60	75	90	99	121	136	144	143	141	138
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	46	58	64	74	75	84	87	85	77	70	64
A2. Alternative Scenario :[Customize, enter title]	46	37	44	53	56	66	74	78	78	77	76
B. Bound Tests											
B1. Real GDP growth	46	62	79	95	106	130	146	155	155	153	152
B2. Primary balance	46	60	76	93	102	124	139	147	146	144	142
B3. Exports	46	60	75	93	102	125	142	150	149	146	144
B4. Other flows 3/	46	60	76	92	101	125	141	149	148	145	143
B5. Depreciation	46	60	76	90	98	120	134	142	141	139	137
B6. Combination of B1-B5	46	58	73	89	97	123	142	146	145	142	143
C. Tailored Tests											
C1. Combined contingent liabilities	46	60	86	99	108	130	145	153	152	149	147
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	46	66	83	102	111	135	149	155	155	153	152
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.

Statement by Ms. Mannathoko and Ms. Nainda on Malawi

December 13, 2021

Since taking over in June last year just after the pandemic hit, the new administration has faced significant challenges having to contend with both COVID-19 impacts and ongoing effects from 2019 weather-related shocks, while working to unwind significant governance and legacy issues left by the previous administration. The pandemic amplified preexisting vulnerabilities, making economic management especially difficult amidst fragility and low donor support. Though real GDP growth in 2021 is projected to rise to 2.2 percent, real per capita income has declined, with the pandemic entrenching scarring amidst persistent fiscal imbalances and elevated public debt. Thus program support from the Fund is becoming increasingly urgent. The new administration has launched Vision 2063 aimed at guiding development plans and propelling Malawi to an inclusive and self-reliant industrialized upper middle-income country. To this end, the authorities are committed to entrenching macroeconomic stability, enabling growth and reducing poverty and inequality. They are working diligently to ensure that necessary reforms are implemented to overcome the crisis, without causing undue social and economic harm which could backfire. However, they will require support from the Fund and the donor community in the short to medium term, even as they pursue reforms to overcome the crisis.

Introduction

1. The Malawian authorities appreciate the candid and constructive discussions with staff during the Article IV consultations. They value Fund advice and broadly share the thrust of staff's appraisal of macroeconomic challenges and related policy priorities. They appreciate the earlier support received under the Rapid Credit Facility and the debt relief under the CCRT, alongside the general allocation of SDRs.

2. Malawi's economy continues to face challenges, including from the impact of the pandemic and frequent weather-related shocks that have raised uncertainty and dampened growth and social outcomes. Notwithstanding the improved harvests in 2021 in parts of the country, over half the population continues to live below the poverty line. Poverty in Malawi is exacerbated by low productivity in the agriculture sector, limited non-farm economic activity, volatile economic growth, and the limited coverage of safety net programs.

3. Exogenous shocks alongside declines in donor support over the past five years of the previous administration, amplified macroeconomic imbalances and set back progress on human and social development. Against this backdrop, the new administration has been working to address governance issues it inherited and reset its relationship with the Fund, and is engaged in negotiations with staff on how best to secure macroeconomic stability, including how to contain the fiscal deficit while boosting growth, and measures needed to place public debt on a sustainable footing. They have requested a new Extended Credit Facility (ECF) program to help them address these challenges and support their pursuit of the key objectives of Vision 2063, while catalyzing critical donor support. They continue to work on the resolution of

outstanding legacy issues in order to pave the way for progress on program negotiations currently underway.

Recent Economic Developments, COVID-19 Vaccine Deployment and Outlook

4. Real GDP is projected to recover from 0.9 percent in 2020, to 2.2 percent in 2021 and 3.5 percent in 2022. The expansion in economic activity is mainly attributed to favorable weather conditions and the support of agricultural input subsidies which contributed to a good harvest and increased tobacco production for export. However, the economy remains heavily impacted by the COVID-19 pandemic. After a severe second wave that largely subsided around March 2021, a third wave beginning in June led to a sharp increase in case numbers in the third quarter.

5. The government of Malawi commenced the first phase of vaccinations, targeting 20 percent of the eligible population, in March 2021. The authorities have administered at least 1,476,957 doses of COVID vaccines so far which translates to about 3.2 percent of the population fully vaccinated. Given this slow rollout, the target of vaccinating 60 percent of the population by December 2022 remains a challenge, owing in part to limited quantities of vaccines. As part of further efforts to ramp up vaccination, the government is also scaling up communication to address vaccine hesitancy.

6. Headline inflation has been trending upward, rising from 7.6 percent in December 2020 to 9.8 percent in October 2021, mainly driven by increases in food, fuel, and agricultural input prices. With ongoing supply chain disruptions related to COVID-19, food inflation remains above 10 percent despite a good harvest. In the external sector, current account deficits continue to constrain gross international reserves.

7. The outlook remains subject to downside risks due to uncertainties, including around the pandemic and recent emergence of the Omicron coronavirus variant. The medium-term outlook is also clouded by ongoing climate change risks that could exacerbate imbalances while deepening economic scarring and poverty. This is because of the impact of climate change on the Malawi economy that is heavily dependent on agriculture, employing nearly 80% of the population primarily in small holder production. The high vulnerability to climatic shocks has significant economic and welfare implications and in light of this macro-criticality, attention to climate risk, adaptation and resilience building could be beneficial for the next Article IV cycle report. In recent years, Malawi has seen a rise in the frequency, intensity and unpredictability of climate shocks. Extreme weather patterns can generate a cycle of crop failure and food insecurity as seasonal dry and rainy conditions are less predictable and more intense. Floods are a major risk, with the two cyclones in 2019 having caused significant loss of life, scarring and population displacement, contributing to the humanitarian situation.

Fiscal Policy and Debt Sustainability

8. The authorities see the need for fiscal adjustment to ensure fiscal and debt sustainability and have been exploring options while embarking on revenue mobilization and expenditure

management measures to narrow the fiscal deficit. In this context, the Domestic Revenue Mobilization Strategy (DRMS) was prepared with support from Fund TA and other development partners, to strengthen tax administration and help expand the tax base. Some of the measures identified in the DRMS are already being implemented, including the introduction of an import withholding tax in the FY 2021/22 Budget.

9. On debt management, the authorities have been consulting closely with staff on stabilizing debt and are currently engaging creditors to help address debt sustainability. They are cognizant of risks and note staff's call for a fast pace of adjustment that will help reduce the risk of debt distress to "moderate" in the medium term. The new PFM Act also makes provision for the creation of a Debt Retirement Fund to be funded via new revenue measures that are under development. The authorities have also scaled down the number of development projects to be funded in the FY 2020/21 budget to limit pressures on the budget and manage domestic debt. They plan to review these projects on a continuous basis. In addition, the commitment control system has been strengthened to operate strictly within budget provisions, in line with the authorities' arrears clearance strategy.

10. Still on expenditure, the authorities have fast-tracked the implementation of the new Integrated Financial Management and Information System (IFMIS) to strengthen expenditure control, particularly for managing multi-year commitments to avoid accumulation of arrears across all Ministries, Departments and Agencies (MDAs). Further, the new Affordable Input Program (AIP), which replaced the Farm Input Subsidy Program (FISP), will be reviewed following a year of implementation, with the review largely focused on enhancing efficiency and reducing the fiscal outlay over time, without compromising the objectives of the scheme.

Monetary, Financial Sector and Exchange Rate Policies

11. The banking sector remains well capitalized, liquid and profitable, though the pandemic and central bank policy response, necessitate risk monitoring. Throughout the pandemic, the Reserve Bank of Malawi (RBM) maintained an accommodative monetary stance. At the onset it lowered the Liquidity Reserve Requirement and the Lombard Rate and activated an Emergency Liquidity Assistance framework to support banks in the event of worsening liquidity conditions. It also granted a debt moratorium and allowed restructuring of loans to SMEs impacted by the pandemic. To strengthen the monitoring of financial sector risks RBM has requested Fund technical assistance, and has intensified banking supervision efforts with daily liquidity risk monitoring and enhanced offsite monitoring.

12. The RBM recognizes the need for greater exchange rate flexibility and is engaged in technical discussions with staff on the least disruptive approach to adjustment. The authorities also concur with staff that the monetary policy stance needs to be stronger to counteract inflationary pressure expected from greater flexibility in the exchange rate, and plan to gradually transition towards an inflation targeting framework by 2025. Given significant debt, however, they are also concerned at the impact of tighter monetary policy on government debt service and the cost of borrowing.

Governance

13. The new administration has been upfront on the need to address governance weaknesses from the previous administration and has prioritized transparency and efficiency in all aspects of government. The authorities reported the possible provision of inaccurate information by the previous administration to the Fund; and have been working closely with staff to resolve this legacy issue. RBM has started submitting appropriate data of higher frequency and improved quality, with measures to avoid similar occurrences in the future. The authorities are undertaking actions more broadly to address legacy issues related to weak governance, including a special audit of foreign exchange reserves of the RBM to be completed before the end of the first half of 2022. The RBM and the Ministry of Finance have also scaled up internal reconciliation exercises and increased the frequency of reporting to the Fund. They have also started implementing TA recommendations around economic governance, including reporting data on gross international reserves in line with the Data Template on International Reserves and Foreign Currency Liquidity.

14. The authorities are making progress on COVID audits, seeking to address capacity constraints. Quarterly statements on commitments and payments of COVID-19 related activities across all MDAs have been produced and published for FY19/20 and FY20/21. Additionally, publication of COVID-19 related procurement details on the Public Procurement and Disposal of Assets Authority (PPDA) website, including on beneficial owner(s) of companies awarded contracts, is progressing. The authorities are also taking measures to strengthen institutions that have a constitutional mandate to fight corruption, including the Anti-Corruption Bureau, the Financial Intelligence Authority and the PPDA.

Growth and Structural Reforms

15. Malawi has significant underexploited mineral, water and tourism potential that could make significant contributions to growth, revenues and development in the future. An analysis of the key transformative structural reforms that would help to unlock this potential may be worth considering in the next Article IV cycle. In the meantime, the authorities are exploring possible investment and growth potential in the mining sector, in addition to prioritizing the export diversification agenda. If successful, this could generate positive growth spillovers and higher export receipts.

16. The authorities agree with staff on the need to prioritize investment under current fiscal constraints. In this regard, they aim to reprioritize capital expenditure and prioritize policies to achieve higher productivity including accelerating human capital investment to foster equity and inclusive growth. This includes incorporating technical and vocational skills fit for the labor market, including entrepreneurship, in their human investment, in line with Vision 2063.

17. The authorities are prioritizing building resilience to climate change considering the country's vulnerability to frequent weather shocks and lingering threats to food security. In this context, they updated the government strategy on climate change in February 2021 to address three key pillars, namely (i) human capacity building to strengthen skills development for the

advancement of green, low emission and climate resilient development (ii) institutional capacity and iii) climate change financing. They look forward to financial and technical support from development partners to support the implementation of their climate strategy.

Conclusion

18. The authorities remain committed to finding the means to ensure the macroeconomic stability essential to support sustainable higher growth, and to addressing legacy issues. They value engagement with the Fund and stress the urgency of a successful conclusion to negotiations for a new multi-year ECF program needed to support stabilization efforts and place the country on a more sustainable path, arresting further deterioration in macroeconomic and socio-economic conditions. The catalytic role played by Fund support will also be critical to help close sizeable financing gaps, and in particular to help mobilize much-needed donor funding. Meanwhile, the authorities remain steadfast in implementing prior actions to lay the groundwork for the Fund-supported program.