December 2004
IMF Country Report No. 04/380

Malawi: 2004 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

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 2004 Article IV consultation with Malawi, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on August 2, 2004, 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 October 18, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 29, 2004 discussion of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper
Ex Post Assessment of Longer-Term Program Engagement

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the 2004 Article IV Consultation with Malawi

Approved by Michael Nowak and Matthew Fisher

October 18, 2004

Mission details

- A staff team visited Lilongwe during July 21-August 2, 2004 to conduct the 2004 Article IV consultation discussions, present the ex post assessment (EPA) of Malawi's long-term engagement with the Fund, and hold talks on a staff-monitored program (SMP). The mission held discussions with the Minister of Finance, Mr. Goodall Gondwe; the Governor of the Reserve Bank of Malawi (RBM), Dr. Ellias Ngalande; other senior officials of the government and public agencies; and donor and business representatives.
- The team comprised Mr. Green (head), Mr. Alvesson, Mr. Steinberg (all AFR), Mr. Baunsgaard (Resident Representative), Ms. Kaendera (IMF Office in Lilongwe), Ms. Mongrut (PDR), and Ms. Roehler (FAD). Mr. Ghosh (PDR) presented the EPA. Ms. Gesami (OED) participated in the policy discussions. Members of the World Bank and African Development Bank worked closely with the Fund staff.

Fund relations

- On December 21, 2000, the Executive Board approved a three-year arrangement under the PRGF for Malawi for SDR 45.1 million (65 percent of quota). The first review was completed on October 20, 2003 and the arrangement was extended through December 20, 2004. The second review could not be completed because of fiscal slippages and delays in completing structural performance criteria. A report for a staff-monitored program was circulated to the board on September 9, 2004 (Country Report No. 04/295).
- Malawi has had two ESAF/PRGF arrangements over the last ten years. An ex post assessment was issued on September 17, 2004 (http://www.imf.org).
- In concluding the 2002 Article IV consultation, Directors noted the disappointing implementation of the 2000 PRGF and stressed that the success of the authorities' program would heavily depend on high-level commitment to fiscal restraint. They welcomed the renewed intention of the authorities to bring the program back on track and cautioned them against any surge in expenditure in the run-up to the 2004 elections. Directors also expressed concern about the food crisis.
- Malawi accepted the obligations of Article VIII, Section 2, 3, and 4 of the Fund's Articles of Agreement in December 1995. Malawi maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Contents Page

Executive Summary

Recent developments

- **Economic performance since the 2002 Article IV consultation has been disappointing.** Malawi has suffered from adverse weather conditions and large fiscal policy slippages. But inflation has been reduced to 10 percent in 2003, and the kwacha-U.S. dollar exchange rate has been stable for the past 12 months.

- **Malawi's Poverty Reduction and Growth Facility (PRGF) arrangement (approved in December 2000) has effectively lapsed**. The second review could not be completed because of spending overruns.

- **Dr Bingu wa Mutharika was elected president in May 2004 with 35 percent of the vote.** President wa Mutharika's commitment to sound fiscal policies and his early actions on corruption have gained broad support across party lines.

- **A staff-monitored program was launched in July 2004 to enable Malawi's new government to establish a strong implementation track record.** The 2004/05 budget was approved in late September and is in line with the SPM. Performance so far has been satisfactory.

Report on the discussions

- **The medium-term outlook depends on success in restoring fiscal discipline.** With strong up-front adjustment and implementation, the 2004/05 budget would avoid an unsustainable spiral of higher domestic debt and interest payments. Medium-term policies aim to provide an environment for private sector growth through a stable macroeconomic environment and an adequate infrastructure.

- **The authorities will continue to pursue an active role in the prevention of food shortages** through a buildup of maize stocks and introduction of a fertilizer subsidy. The government has also appealed for assistance from donors to address the expected food shortage this year.

- **The authorities agreed with the main findings of the Ex Post Assessment of Malawi's performance under Fund-supported programs (EPA).** However, they felt that the structural reform agenda had at times been overloaded and program targets overly ambitious.

- **A new PRGF arrangement could be considered after a six-month track record of sustained policy implementation and taking into account the Board's views of the EPA.**

I. INTRODUCTION

1. **Economic performance in Malawi since the 2002 Article IV consultation has been disappointing.** Fiscal policy slippages over much of the period have resulted in a precarious domestic debt situation and a high level of public expenditures. Economic activity picked up from the drought-related contraction in 2001, but the recovery has been muted in part because very high interest rates have crowded out the private sector.

2. **There have also been some positive developments**. Inflation was reduced from more than 20 percent in early 2002 to less than 10 percent at the end of 2003. Commitment to the structural agenda strengthened markedly at the end of 2003, and several long-standing objectives have been completed. The formulation and execution of fiscal policy has also improved in recent months.

3. **Malawi's Poverty Reduction and Growth Facility (PRGF) arrangement (approved in December 2000) has effectively lapsed.** A staff report for the second PRGF review was circulated to Directors on April 8, 2004 but was withdrawn from consideration because of spending overruns.

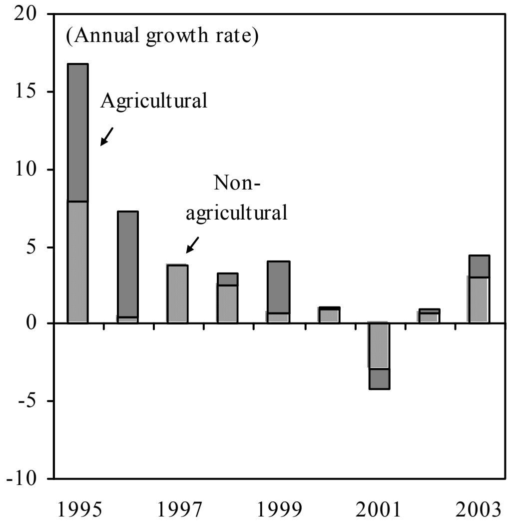
4. **Dr. Bingu wa Mutharika was elected President in Malawi's third multiparty elections.** International observers reported the election as being overall free, although they were marred by many irregularities. The President's party, the United Democratic Front (UDF), failed to gain a parliamentary majority, but has formed a coalition with several small parties and independent members of parliament. President wa Mutharika's commitment to sound fiscal policies and his early actions on corruption have gained broad support across party lines.

5. **A Staff Monitored Program (SMP) was adopted.** During the consultation discussions, the authorities asked Fund staff to monitor a program to establish a track record that could lead to a new PRGF arrangement. The SMP covers the 2004/05 fiscal year (July-June) and will be monitored quarterly. With strong performance over two test dates (six months), a PRGF could be considered.

II. Recent Developments and Program Performance

A. Economic Developments and Structural Reforms

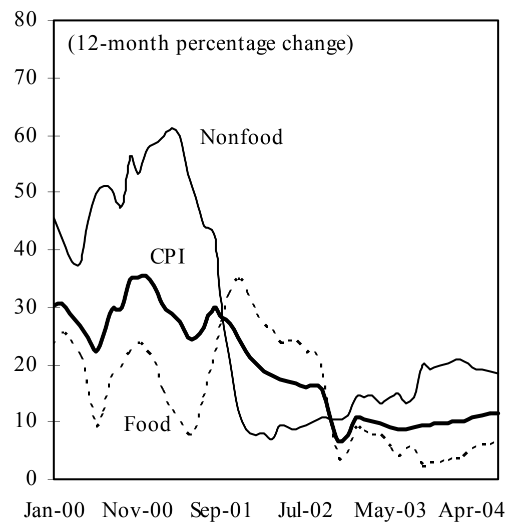
Output has rebounded ...



6. **Malawi enjoyed a modest economic recovery in 2002 and 2003, following the drought-related contraction in 2001**. The economy grew by an average of 3 percent in 2002-03, but stagnated in per capita terms. Agricultural production has rebounded from the 2001 drought, and maize production reached normal levels in 2003. The 2004 maize harvest is, however, estimated to be below normal and President wa Mutharika has appealed for humanitarian assistance. Tobacco production decreased in 2003 after food shortages in 2002 led farmers to shift to maize production, but is expected to grow by 10 percent in 2004, in part reflecting better market access for smallholder farmers. The nonfarm sector has been adversely affected by large fiscal deficits, very high interest rates, and infrastructure constraints. Manufacturing—mainly agro-processing activities—and distribution (together 1/3 of GDP) stagnated in 2002-03 and industrial activity remained very weak.

7. **Inflation declined in 2002 and 2003 but has now begun to pick up.** Inflation decreased from above 20 percent in early 2002 to single digits in 2003, reflecting high real interest rates and a post-drought decline in agricultural prices. An expansionary policy stance in FY2003/04 and the associated currency depreciation, however, has recently put upward pressure on prices.

... and inflation has declined.



8. **Malawi is one of the poorest countries in southern Africa, with per capita GDP of about US$160**. Approximately two-thirds of the population was estimated to live on less than one dollar a day in 1997-98; recent adverse weather conditions and the high incidence of HIV/AIDS are likely to have worsened the incidence of poverty. Since 1990, progress has been made in improving other social indicators such as literacy rates and access to better drinking water.

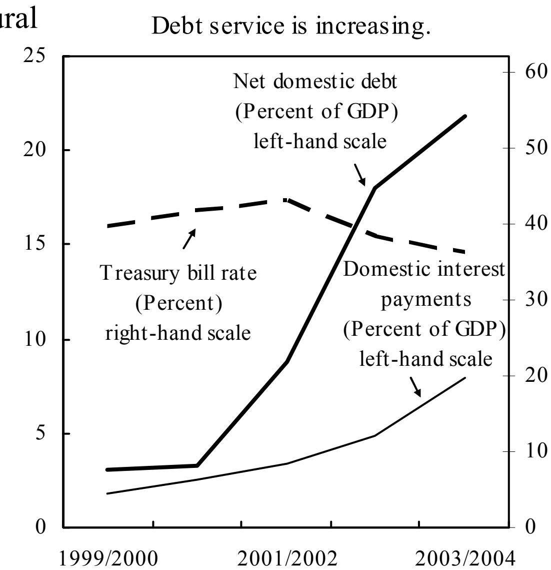
Despite an expansionary fiscal policy, pro-poor expenditures have been below what was advocated in the Malawi Poverty Reduction Strategy Paper (MPRSP).[1]

Millennium Development Goals: Selected Indicators

	1990	1995	2001	2002
Adult literacy rate (percent of people ages 15+)	51.8	55.9	61.0	61.8
Youth literacy rate (percent of people ages 15-24)	63.2	67.3	71.8	72.5
Ratio of girls to boys in primary and secondary education	78.9	88.4	...	...
Under 5 mortality rate (per 1,000)	241.0	216.0	188.0	182.0
Prevalence of HIV (percent of women ages 15-24)	...	...	14.9	...
Access to an improved water source (percent of population)	49.0	...	57.0	...
Fixed line and mobile telephones (per 1,000 people)	3.1	3.6	10.6	...
Life expectancy at birth (years)	44.6	41.9	38.2	37.5

Source: http://www.developmentgoals.org/

9. **Government domestic debt more than doubled over the past two financial years to 26 percent of GDP at end-June 2004**. The increase was caused by large unbudgeted expenditures, shortfalls in external budget support (which were partly due to poor implementation of fiscal, macroeconomic, and structural policies), and high real interest rates relative to economic growth (Box 1). Nevertheless, due to very strong revenue performance, there was fiscal adjustment of about 1 percent of GDP in each of 2002/03 and 2003/04 as measured by the underlying balance.[2] This adjustment, however, was much less than originally programmed.



10. **Revenue, especially tax revenue, performed well during 2002-04**. Excise taxes on alcohol, tobacco and petroleum products

[1] Malawi Government (2003), *The Annual Review of the Malawi Poverty Reduction Strategy Paper*, Ministry of Economic Planning and Development.

[2] This is a measure of domestic primary balance: overall balance plus statistical discrepancy, excluding grants, revenue from maize, total interest, expenditure for maize, and foreign financed development expenditures.

Box 1. Fiscal Expenditures in 2002/03-03/04

Domestic primary expenditure exceeded program plans by more than 5 percent of GDP in each of 2002/03 and 2003/04. Largely unbudgeted expenditure for maize imports of 3.9 percent of GDP were a major factor in 2002/03, while 2003/04 was impacted by above budget spending in executive services, national assembly, police, military, arrears repayments, subventions, and costs of the elections. Moreover, wage overruns occurred in both years.

The PRGF went off track in early 2004. The expenditure program formulated during the first PRGF review was derailed early in the year because some agreed measures were not implemented and because of a shortfall in external budget support. A revised program was formulated in March 2004 based on the approved supplementary budget (which included a revised set of measures), but indications of overspending soon emerged. The authorities were not able to implement the revised program, and domestic primary expenditure exceeded the revised target by 3½ percent of GDP.

Budget developments 2002/03 - 2004/05 (as percent of GDP, unless otherwise stated)

	2001/02	2002/03		2003/04			2004/05
	Actual	Prog. 1/	Actual	Prog. 2/	Prog. 3/	Actual	SMP
Revenue and grants	24.1	28.6	27.7	34.7	35.2	36.0	35.7
Tax revenue	15.3	16.1	17.7	19.3	19.5	20.3	20.7
Non-tax revenue	1.9	1.9	3.1	2.5	3.7	3.2	3.3
Grants	6.9	10.6	6.9	13.0	12.0	12.5	11.7
Total expenditure and net lending	31.9	31.4	39.7	35.2	40.3	43.3	40.0
Wages and salaries	6.9	6.2	7.1	6.3	6.6	6.8	7.1
Interest	5.1	4.7	7.1	9.6	10.7	11.0	9.0
Domestic	3.9	3.2	5.7	8.0	9.2	9.5	7.8
Foreign	1.2	1.4	1.4	1.5	1.5	1.5	1.2
Other current spending	12.5	12.3	17.9	10.1	11.5	14.2	15.1
Domestic develoment	1.5	1.7	1.5	1.2	1.3	1.8	1.0
Foreign development	5.8	6.5	6.2	8.1	10.2	9.5	7.8
Overall Balance	-7.9	-2.7	-12.1	-0.5	-5.2	-7.3	-4.3
Financing	6.9	2.7	11.7	1.8	6.4	8.2	4.3
Foreign total	-0.2	6.5	-0.5	4.8	4.9	0.2	2.3
Domestic	7.1	-3.7	12.2	-3.1	1.5	8.0	1.9
Memorandum items:							
Underlying balance	-2.8	-0.9	-1.8	2.9	1.8	-0.9	1.2
Net domestic debt (central government)	10.2	5.1	21.2	15.6	19.5	25.9	23.7
Net foreign financing contribution 4/	0.8	10.5	0.3	9.7	6.6	3.2	6.2
Domestic primary expenditure	21.0	20.2	26.4	17.6	19.4	22.8	23.2
Pro-poor expenditures	6.6	6.2	7.2	7.0	6.7	6.8	7.5
Maize operations: revenue less expenditure	...	-1.1	-3.6	0.0	0.8	0.7	-0.3
Nominal GDP (millions of Kwacha)	133,004	150,794	154,340	174,600	181,525	181,560	216,129

Sources: Malawi authorities, and IMF staff estimates.

1/ Track record program, indicative targets, July 2002 (Country Report No. 02/181), including the cost of the 2001/02 and 2002/03 r

2/ First PRGF Review, October 2003 (Country Report No. 03/344).

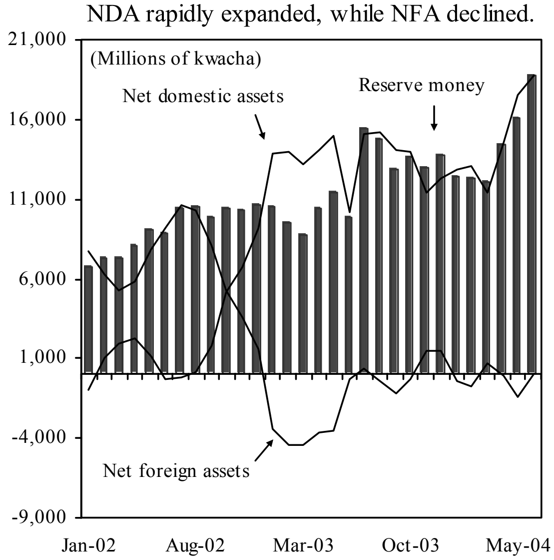
3/ Draft Second Review, April 2004 (not considered by the Board).

4/ Foreign grants plus foreign financing, less foreign financed development projects.

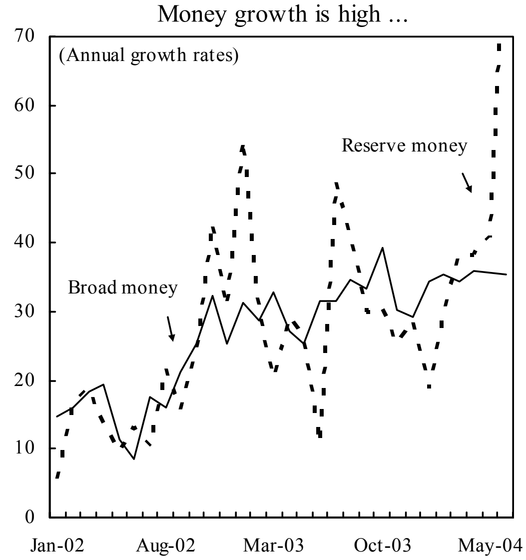
were increased, and an additional tax bracket was introduced for the personal income tax (at a 40 percent rate). The surtax (a VAT) was extended to the wholesale and retail sector in November 2002, but the rate was lowered from 20 percent to 17.5 percent in mid-2003. In addition, the Malawi Revenue Authority became fully operational and tax administration improved significantly. Nontax revenue benefited from increases in various levies, and in 2003/04 from sales proceeds for the stock of maize.

11. **Reflecting the large liquidity injection from the expansionary fiscal stance and an easier credit policy, monetary aggregates have grown substantially.** Believing that higher interest rates would not absorb liquidity, the RBM instead lowered the Bank Rate (discount rate) in three steps to 25 percent,[3] and limited foreign exchange sales due to low reserves. As a result, broad money growth has been consistently near or above 30 percent since late 2002. An unexplained rise in cash outside the banking system further complicated sterilization efforts.

NDA rapidly expanded, while NFA declined.



Money growth is high ...



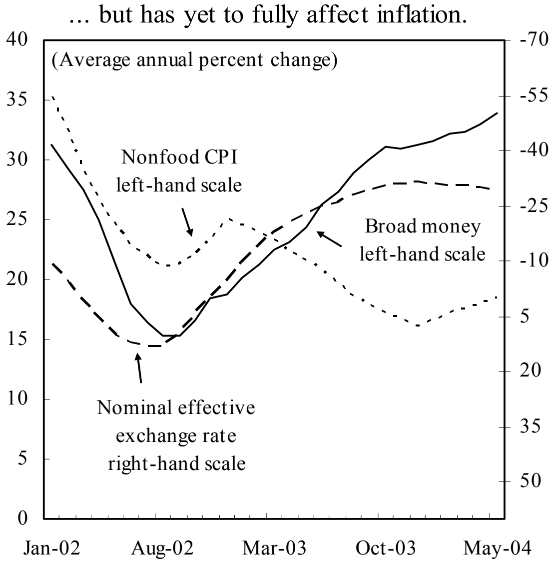
12. **The real effective exchange rate declined in 2002/03 as changes in the nominal exchange rate outpaced inflation.** The real and nominal effective exchange rates

---

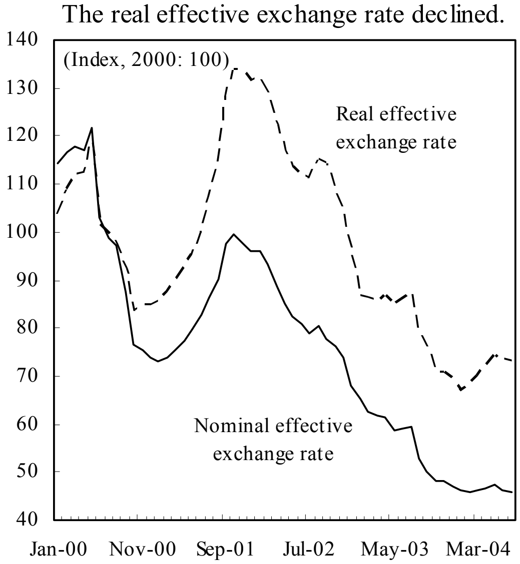
[3] The reduction did not appear to affect the RBM's ability to roll over outstanding treasury or RBM bills. It is possible that treasury bill yields have not reflected market-clearing conditions. The RBM places an effective ceiling on yields by rejecting any bid above the Bank Rate, by purchasing treasury bills not sold at auction, which must then be resold to meet monetary targets, and because of the government's weak fiscal position.

depreciated by nearly 50 percent between January 2002 and September 2003, mainly reflecting the sharp rise in monetary aggregates, the fragile reserve position at the RBM and policy uncertainty, especially during 2003. Since August 2003, the US$/kwacha rate was stable while inflation has begun to accelerate.

... but has yet to fully affect inflation.



The real effective exchange rate declined.

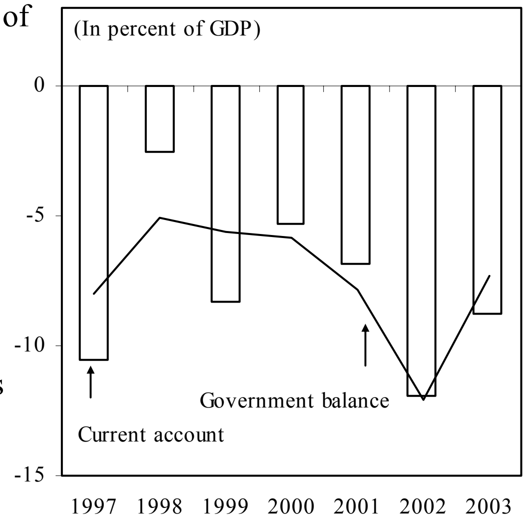


13. **The financial sector continues to benefit from high returns on government securities**.[4] Banks remained well capitalized and have minimized the risks associated with a build up in foreign exchange deposits by a matching rise in foreign currency assets. The ratio of nonperforming loans declined from 13 percent in June 2003 to 10 percent in March 2004, but remains an issue for a few banks where on-site examinations have been stepped up.

[4] Government securities make up about one-half of commercial bank assets.

14. **Malawi's external current account deficit (excluding grants) mirrored changes in the government balance and the emergency maize imports in 2002**. The financing of the 2002 current account deficit of 25 percent of GDP—about one-half of which was related to maize imports—was financed through a drawdown in official reserves and external assistance. Donors resumed balance of payments support following the approval of the first PRGF review in late 2003, but not in the amounts originally expected. This assistance was curtailed when program implementation went off track, but was resumed in September 2004 as prospects for macroeconomic stability improved. The terms of trade have deteriorated reflecting increases in the price of food imports and a rising world market price for oil. Export volumes in 2002 and 2003 stagnated mainly on account of slow growth of tobacco production, while import volumes reflect the large importation of maize in 2002.

The government deficit drives the current account.



15. **The structural reform agenda has advanced, though unevenly and at a slower than anticipated pace.** Several parastatal corporations were privatized and reforms have been implemented in the telecommunication, electricity and water sectors. ADMARC's monopoly in the marketing of maize has been abolished and the law regulating ADMARC was repealed in December 2003, paving the way for a separation of the social and commercial activities of the firm. The Anti-Corruption Bureau (ACB) was strengthened in early 2004 through an amendment to the Corrupt Practices Act that requires the cases referred to the Director of Public Prosecution but not prosecuted be reported to parliament. The new administration has declared a policy of zero tolerance on corruption and has already taken steps to enforce this policy. In particular, several high ranking government and parastatal officials have been arrested for corruption and a special commission has issued a report on the mismanagement of the Strategic Grain Reserve (SGR) in 2000-01, including specific allegations of financial improprieties.

16. **The public expenditure management procedures have been strengthened, but the internal controls remain weak.** A new Public Finance Management Act, Public Audit Act, and Public Procurement Act were passed by parliament in mid-2003, and they are now being implemented. For the first time in many years, the final public accounts (for the 2002/03 fiscal year) were ready for presentation to parliament within 12 months. A new Department of Public Procurement under the Office of the President is being funded by its own budget line for the first time in 2004/05. The first phase of an external audit of domestic arrears is under way and an interim report has been completed. Numerous donor-assisted programs to strengthen expenditure procedures are under way, but implementation has been slow.

B. Program Performance

17. **Performance under the PRGF arrangement was disappointing.** The three year arrangement was approved in December 2000 and subsequently extended until December 2004. Unfortunately, only two of eight scheduled disbursements were made because of spending overruns and delays in completing some of the structural objectives. Because the arrangement is set to expire, the authorities requested assistance in establishing a performance track record within an SMP. A new PRGF arrangement would take into account (i) the IMF Executive Board's views on the EPA, and (ii) strong performance over two test dates (six months).

III. Report on Discussions

The discussions focused on policy actions to strengthen macroeconomic performance and medium-term policies and prospects and the ex post assessment of Malawi's longer-term engagement with the Fund.

18. **Malawi's overriding economic policy challenge is to establish conditions for sustained growth and significant poverty reduction**. In the near term the authorities need to address domestic debt by bringing public expenditure under control, further reduce inflation by reining in monetary growth, and foster private sector development and job creation through structural reforms and investment in basic infrastructure.

A. Medium-Term Outlook

19. **The outlook for economic growth and poverty reduction will depend on the success of restoring fiscal discipline in the very near term.** To underscore the critical importance of immediate action against the consequences of adverse debt dynamics, the staff presented a delayed adjustment scenario in which, government spending was not reined in until 2005/06 (lower panel of text table). In these hypothetical projections, domestic borrowing would rise, inflation accelerates, interest rates remain high, and debt increase. The government would be forced to adjust in 2005/06, but at a significant cost to the economy including lower growth and fewer resources available for pro-poor programs. The staff stressed, and the authorities agreed, that delayed policy actions and their consequences were to be avoided.

20. **The authorities presented a 2004/05 budget framework to the mission that incorporated significant fiscal adjustment.** The resulting budget, which was approved by parliament in late September, was incorporated into the 2004/05 adjustment scenario projections (Box 2).

Malawi: Medium Term, 2002/03–20008/09

	2002/03 Est.	2003/04 Est.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.	2008/09 Proj.
Adjustment scenario							
Real							
Real GDP growth	3.1	4.1	4.1	4.3	4.9	5.6	5.9
Inflation (average)	10.5	10.4	19.9	9.4	7.8	6.2	6.0
Fiscal (in percent of GDP)							
Revenues	20.7	23.5	24.0	23.7	23.6	23.5	23.4
Grants	6.9	12.5	11.7	11.9	10.0	8.3	7.8
Expenditures	39.7	43.3	40.0	38.3	36.0	35.1	34.5
Of which: Domestic primary expenditures 1/	26.4	22.8	23.2	22.2	22.5	22.7	22.9
Of which: Domestic interest	5.7	9.5	7.8	6.8	4.2	3.0	2.3
Overall balance (including grants)	-12.1	-7.3	-4.3	-2.7	-2.4	-3.3	-3.3
Underlying balance 2/	-1.8	-0.9	1.2	1.6	1.1	0.8	0.5
Foreign financing (net)	-0.5	0.2	2.3	0.2	1.2	2.8	2.5
Domestic financing (net)	12.2	8.0	1.9	2.5	1.2	0.5	0.8
Statistical discrepancy	0.3	-0.9	0.0	0.0	0.0	0.0	0.0
Memorandum domestic debt dynamic variables							
Central government debt (net, percent of GDP)	21.2	25.9	23.7	22.9	21.5	19.6	18.3
Interest rate (weighted, percent)	42.2	37.9	31.6	26.2	19.9	15.7	12.7
Nominal GDP growth (percent)	15.5	17.6	19.0	16.2	13.1	12.1	11.9
Primary balance plus foreign finance (percent of GDP)	-6.8	2.4	5.9	4.4	3.0	2.6	1.5
Debt stabilizing level of primary balance and foreign financing (percent of GDP)	2.7	4.3	3.3	2.4	1.6	0.8	0.2
Delayed adjustment scenario							
Real							
Real GDP growth (in percent)	3.1	4.1	2.5	1.0	2.0	3.0	3.0
Inflation (average)	10.5	10.4	30.3	34.0	16.0	12.0	10.0
Fiscal (in percent of GDP)							
Revenues	20.7	23.5	22.2	22.2	22.4	22.6	22.6
Grants	6.9	12.5	9.4	8.0	7.9	7.9	7.8
Expenditures	39.7	43.3	42.9	37.6	36.7	35.4	33.3
Of which: Domestic primary expenditures 1/	26.4	22.8	23.7	19.2	17.7	17.2	16.5
Of which: Domestic interest	5.7	9.5	9.1	9.6	9.7	8.9	7.5
Overall balance (including grants)	-12.1	-7.3	-11.3	-7.4	-6.4	-4.9	-2.9
Underlying balance 2/	-1.8	-0.9	-0.9	3.0	4.7	5.4	6.1
Foreign financing (net)	-0.5	0.2	1.2	0.2	0.6	2.8	2.5
Domestic financing	12.2	8.0	10.1	7.2	5.8	2.1	0.4
Statistical discrepancy	0.3	-0.9	0.0	0.0	0.0	0.0	0.0
Memorandum domestic debt dynamic variables							
Central government debt (net, percent GDP)	21.2	25.9	27.3	29.9	31.8	29.9	27.1
Interest rate (weighted, percent)	42.2	37.9	41.4	36.3	33.4	30.7	27.7
Nominal GDP growth (percent)	15.5	17.6	40.0	20.0	15.0	14.0	12.0
Primary balance plus foreign finance (percent of GDP)	-6.8	2.4	-1.0	2.4	3.9	6.8	7.1
Debt stabilizing level of primary balance and foreign financing (percent of GDP)	2.7	4.3	0.4	4.5	5.5	5.3	4.7

Sources: Malawi authorities; and Fund staff estimates and projections

1/ Expenditures excluding foreign financed development expenditures, and interest payments on foreign and domestic debt.

2/ A measure of domestic primary balance, excluding maize operations. Definition: Overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize, plus foreign financed development expenditures.

Box 2. Staff-Monitored Program for FY2004/05

The 2004/05 budget limits domestic borrowing to 2 percent of GDP, in line with the SMP. The budget aims at restraining spending across government while accommodating priority initiatives. Revenue would increase somewhat owing to tax efficiency gains and increases in nontax user fees. The fiscal effort measured by the underlying balance is targeted at 2 percent of GDP. A mid-year review is planned.

Priority expenditure initiatives include civil service wage reform, food security, ADMARC restructuring, and domestic arrears repayment. The food security policy has two components: maize imports and a targeted input program that provides subsidized fertilizer and seed maize. Excluding the wage reform, these initiatives add about 2¼ percent of GDP to expenditures. Wage reform is expected to hold the wage bill close to 7 percent of GDP and give civil servants the first general increase in several years. The government may achieve some savings on a net basis because compensation formerly in the form of allowances will be shifted to taxable money income. High priority pro-poor expenditures (PPEs) are being protected from budget cuts.

Money will remain the nominal anchor to achieve 10 percent inflation by the end of 2005. The RBM will need to contain broad money growth and mop up the liquidity overhang that built up at the end of the 2003/04 fiscal year. The buildup of cash outside the banking system during April-June 2004 has added uncertainty to monetary operations. The exchange rate will continue to be market determined.

Structural measures focus on financial management. As recommended in the EPA, they will be limited to areas under the direct control of the authorities. The authorities and staff agreed that strengthening budget monitoring and control was a critical first step in restoring fiscal discipline. Specific measures are included in the SMP (Country Report No. 04/295, Table 2 in Appendix I).

Key program risks are budget implementation and inflation. The authorities affirmed their commitment to budget objectives, but acknowledged that weak expenditure controls could undermine spending targets. Inflation projections are also uncertain because of the monetary overhang and the recent divergence in broad money and the price level.

21. **Projections for the remaining years in this scenario were seen as illustrative and would be refined in the near future**. In particular, the projections do not include estimates of savings or efficiency gains related to the government restructuring that is now under way. These could be used to achieve the government's objective of reducing the dependency on donor assistance and implement a tax reform.

22. **In the adjustment scenario, the underlying fiscal balance would improve by about 2 percent in 2004/05 through fiscal restraint.** Domestic interest payments would fall compared with 2003/04 because of the reduction in interest rates from 45 to 25 percent

(November 2003 May 2004) and the reduction in the domestic debt ratio.[5] The adjustment in 2004/05 creates conditions that would allow the debt ratio and interest rate to decline so that the government can raise pro-poor spending and the private sector can raise its investment. In consequence, economic growth would pick up to the 5-6 percent annual rate needed for significant poverty reduction.

23. **In addition to the debt dynamics highlighted above, the outlook is subject to several risks.** First, the economy remains vulnerable to weather shocks that jeopardize food security and also export performance. Second is the spread of HIV/AIDS. Unless the epidemic is contained and the effects are mitigated, the disease could seriously limit the quality of public sector services (in particular in the health and education sectors) and have a negative impact on economic growth. Third, the reserve position of the RBM could come under pressure, for example if external donor support falls off. Fourth, higher energy or fertilizer prices could cause spending pressures and the balance of payments pressures.

B. Medium-Term Growth Strategy

24. **A new medium-term growth strategy was developed jointly by government officials and private sector representatives to complement Malawi's Poverty Reduction Strategy Paper (MPRSP).** Under the plan, government would facilitate economic growth and job creation by providing the private sector with a stable macroeconomic environment, a reliable public infrastructure, and efficient government institutions. Business representatives emphasized that they face many impediments to production and business development, in particular transportation bottlenecks, electricity shortages, and very high interest rates.

25. **The authorities indicated that Malawi's medium-term growth would stem from the agriculture sector reflecting the dominance of this sector in the economy and Malawi's resource endowments.** While the medium-term strategy for the sector was under review, a new land reform policy has already been approved, with enabling legislation expected sometime in 2005, and the government recently announced a strengthened rural credit scheme. The authorities also emphasized the need for diversification away from tobacco, for example, through agro-processing, textiles, and tourism. They assured the staff that these industries were not being targeted and investment and production decisions would be left to the private sector. Privatization of remaining government-owned business, including Air Malawi and the electricity utility, had been put on hold pending a review by the new government.

C. Fiscal Policy

26. **The immediate fiscal policy objective is to arrest adverse debt dynamics by limiting spending to high priority areas.** The government initially targeted zero domestic

[5] The debt ratio would fall because of the primary surplus, lower nominal interest rates for some of the year, and higher inflation.

borrowing in its draft budget framework, mainly through limits on travel, postponement of nonessential purchases and new domestically-funded development projects, and buoyant revenue. However, in order to set realistic targets, the mission indicated that some domestic borrowing would be consistent with reducing the debt to GDP ratio and would make room for the government's new initiatives including wage reform and food security. The authorities agreed with the analysis, and targeted domestic borrowing of 2 percent of GDP. They indicated that additional resources, for example from higher tax collections or a lower debt interest bill, would be earmarked for debt reduction. This would foster lower interest rates and reduce the interest burden. In the event of unanticipated spending pressures or a shortfall in resources, spending restraint would be considered.

27. **In the medium term, the authorities intend to reduce the ratio of expenditures to GDP to lower Malawi's tax burden and dependence on donor assistance**. As a first step, the government announced a restructuring plan including reductions in the number of cabinet positions (already accomplished) and in the number of ministries, and the relocation of the president's office to Lilongwe where ministries are located (completed). Savings could be in the range of ½ to 1 percent of GDP a year, but firm savings—and initial cost—estimates are not yet available. They will depend on how individual ministries can improve efficiency as they are merged and on the timing of staff reorganization including a reduction in the number of top civil servants. The authorities and staff agreed that medium-term fiscal policy initiatives would be reviewed in connection with the midyear budget review when the new government will have had time to firm its plans. It would also work with Malawi's development partners to increase the grant component of external assistance in order to avoid a buildup in external debt.

28. **Volatile external aid has reflected recurrent slippages in policy implementation and underscored the importance of sustained policy execution**.[6] As concluded in the EPA, the stability of resources available to the government would be increased with more realistic projections of budget support and assumptions related to the authorities' ability to complete structural measures on which some budget support is conditioned. In mid-2003/04, for example, budget support disbursements equivalent to 4 percent of GDP were delayed when large fiscal slippages became apparent and when certain structural targets were not accomplished. Thus, uneven implementation of domestic policies contributed to volatile donor support that in turn contributed to macroeconomic instability through higher domestic financing and monetary expansion.

29. **Further progress in strengthening expenditure management and medium-term budget planning is critical.** The authorities agreed with the EPA conclusion that budget

---

[6] Aid inflows averaged 13.7 percent over the past five years and ranged from 17.8 percent in 2000/01 to 10.1 percent in 2001/02. See "Malawi: Volatility and Predictability of External Aid Inflows" in the selected issues paper.

execution and monitoring capacity needed to be rebuilt and have requested technical assistance from the IMF and other development partners for this purpose.

30. **The recent rise in world petroleum prices has put pressure on public finances.** In response, the Ministry of Finance informed ministries that budget allocations would not be increased to accommodate higher fuel and utility prices. In addition, fuel allowances would be frozen.[7] The authorities acknowledged that pump prices had not been adjusted since March 2004, against recommendations by the Petroleum Pricing Board. Because the stabilization fund had been exhausted, they said that a price increase was necessary and might be accomplished in conjunction with the consolidation of fuel taxes and levies into a single charge. The staff supported the authorities' view that domestic prices need to be adjusted as a means of both reducing budget pressure and making local prices consistent with world markets. This would encourage domestic users to adjust their fuel consumption.

D. Monetary and Exchange Rate Policy

31. **Money will remain the nominal anchor to achieve 10 percent inflation by end-2005, and reduce it further to 5-8 percent range in the medium term**. The RBM will need to mop up the liquidity overhang that built up at the end of the 2003/04 fiscal year and decided to postpone plans to reduce the liquid reserve requirement until market conditions permit. The unusual rise in cash outside of the banking system during April-June 2004 has added uncertainty to monetary operations, but the authorities indicated that they would monitor bank deposits and credit on a weekly basis to limit the possibility of related monetary overruns. The authorities further indicated that they would raise the Bank Rate if necessary to meet the monetary program objectives. In the medium term, control of monetary aggregates will be simplified with improved fiscal discipline.

32. **The RBM stressed that the exchange rate would continue to be market determined.** Its intervention in the foreign exchange market would be limited to meeting the net international reserve target and moderating seasonal fluctuations, without attempting to influence underlying trends. In the near term, intervention will be constrained by current low reserve levels, but will also be facilitated by the RBM's decision to maintain the foreign exchange surrender requirement at 40 percent.[8] The authorities were considering formalizing this approach, perhaps through a target zone formula. However, this would need to wait until reserves were rebuilt and sustainable fiscal policy restored. The staff agreed that the existing

[7] Fuel allowances for most civil servants were eliminated as of October 1, 2004. However, some contract employees will receive this allowance until their contracts expire.

[8] However, the tobacco, sugar, and tea surrender requirement is 60 percent (to commercial banks), and 100 percent of smallholders' proceeds from tobacco auctions have to be converted into kwacha by the RBM.

exchange arrangement was desirable in the current situation where Malawi is dependent on a single export crop and related seasonal variations in monetary variables. The level of the real exchange rate was broadly appropriate as witnessed by buoyant tobacco exports in 2004 and private sector efforts to expand its production. The impact of the exchange rate on plans to diversify the export base is difficult to determine at this time because of high interest rates and other impediments to private sector growth.

E. Trade Policies

33. **The trade system is largely free of restrictions**. The authorities reported that by mid-2003 they had removed all licenses and bans imposed on imports from Zimbabwe, except for the license on cement. The simple average tariff rate has remained at about 14 percent since 2001. The maximum rate in the four tariff bands is 30 percent.[9]

34. **Regional integration continues to be framed by SADC and the Common Market for Eastern and Southern Africa (COMESA).** Malawi is ahead of other members of COMESA in tariff reduction and, following World Bank advice, plans to press the case for a common external tariff that is in line with their tariff structure, instead of the 30 percent that is proposed.

F. Ex Post Assessment of Malawi's Performance Under Fund-Supported Programs

35. **The mission explained that future Fund involvement would be guided by the Board's evaluation of the EPA report**. The main findings were that:

- Performance under Fund-supported programs had generally fallen short of expectations because of a lack of ownership, weak planning, insufficient monitoring, and lax enforcement of regulations.

- External resources had not always been put to good use because of limited implementation capacity and governance issues; and

- The periods of fastest growth in Malawi had coincided with implementation of relatively prudent fiscal and monetary policies.

36. **The authorities agreed with these findings, but emphasized some shortcomings in past program design (Appendix I)**. Specifically, while they did not dispute the need for macroeconomic stabilization, they felt that the structural reform agenda has at times been overloaded and program targets have been overly ambitious; they strongly concurred with the view expressed in the EPA report that the fiscal targets set at the time of the first review of the PRGF were, with the benefit of hindsight, too demanding, especially given the shortfall of donor support.

---

[9] The Fund index of trade restrictiveness is estimated at 2, unchanged from 2001.

37. **The authorities wondered whether their poor implementation record also reflected a lack of ownership stemming from key reform measures often being identified by Fund missions, rather than by the authorities themselves**. Missions had not always demonstrated sufficient flexibility in program discussions or taken into consideration capacity constraints. They also observed that some delays in observing structural performance criteria during September-December 2003 were due to reasons beyond their control, but acknowledged that slippages at the highest political levels had been responsible for frequent expenditure overruns. Structural measures under the SMP were therefore limited to areas within the authorities' direct control. The authorities also indicated that they would make sure that future structural measures could be achieved before agreeing to a target completion date.

38. **The authorities expressed concern that the draft EPA report did not sufficiently recognize the importance of the Fund's continued support for Malawi's adjustment and reform effort.** They stressed the risk that any prolonged disengagement by the Fund could undermine the stabilization effort, forcing the government to resort to inflationary finance or costly domestic borrowing; donor support—which accounts for a significant share of the recurrent budget—was contingent on a Fund-supported program. The staff agreed to provide periodic assessments of Malawi's performance to other development partners in an interim period and work toward a new PRGF arrangement after six months of strong performance.

G. The PRSP Process

39. **The realization of the poverty reduction goals outlined in the Malawi Poverty Reduction Strategy Paper (MPRSP) is jeopardized by lower-than-planned pro-poor expenditures and GDP growth.** Pro-poor spending has been crowded out of the government budget by rising domestic interest payments and other expenditures (Box 1). It is estimated that an annual growth rate of more than 5 percent per year is required to achieve the Millennium Development Goal (MDG) of income poverty reduction to below 40 percent of the population. More generally, the lack of reliable information has limited assessment of other MDGs.

40. **Malawi's external debt sustainability indicators deteriorated somewhat after the HIPC Decision Point was reached in 2000 (Appendix VIII).** Preliminary information shows that debt-to-exports ratios, before any debt relief, are higher than those envisaged at the decision point. The NPV of debt-to-exports is now estimated to peak at 327 percent in 2003, mainly because of lower than expected tobacco exports. Based on preliminary debt sustainability analysis, external debt remains a serious concern, even after the HIPC completion point is reached. Sustaining faster growth through prudent policies will be critical. The alternative scenarios show that Malawi underscores the need for borrowing under concessional terms only and the critical need to shift toward more reliance on grants.

H. Food Security Policies

41. **The authorities will continue to pursue actively policies to prevent food shortages.** In the near term, the government intends to purchase up to 130,000 metric tons of maize to offset to the lower than average harvest this year (Box 3). They are also looking at medium-term improvements in the agricultural sector, such as an efficient infrastructure for transport, to reduce the risk of large swings in the local production and prices.

42. **The government has introduced a two-tier fertilizer subsidy.** About 800,000 subsistence farmers would receive fertilizer and seed (starter pack) under a targeted input program. Other small and some midsize farmers would receive a fertilizer subsidy that would offset part of the recent rise in fertilizer costs.

43. **The government explained that the fertilizer subsidy was necessary in the near term, in part because local infrastructure and market inefficiencies put the cost of fertilizer out of the reach of many farmers.** The shock to world fertilizer prices was also a factor. The staff expressed concern about the sustainability of fertilizer subsidy, but was reassured by government and some other experts that the burden could be reduced when structural impediments in the fertilizer market were addressed. These would be taken up as part of the overall review of agriculture policy.

Box 3. Interim HIPC Debt Relief

HIPC interim relief has been granted by some multilateral and official creditors. Delays in program implementation affected the delivery of Fund's interim assistance. However, it was resumed after the approval of the first PRGF review and extended until September 2004. Interim assistance approved by the AfDB at the time of the decision point was exhausted by end-2003. Other multilateral creditors have indicated that they will start providing relief after the completion point. Bilateral agreements covering the original interim period were signed with all Paris Club creditors, except France. The second and third phases of the Paris Club agreement signed in March 2001 entered into force in November 2003, extending the interim period until end-2004. In this connection, agreements with Germany, Italy, Spain, and Sweden are still pending. The government of Japan decided to change the way it delivers debt relief in late 2002. Instead of providing grants in return for repayment of ODA debt, it will forgive the debt as it becomes due. The formal agreement between the governments of Malawi and Japan is expected to be signed soon. It has also been decided that Japan's official commercial debt will be rescheduled under Paris Club terms.

Box 4. Government Maize operations in FY 2003/04 and 2004/05

During the 2003/04 fiscal year, the National Food Reserve Agency disposed of the entire Strategic Grain Reserve to avoid spoilage. Approximately 80,000 tons of maize were sold domestically through ADMARC and 46,000 tons were made available to WFP to be distributed to vulnerable parts of the population. About 52,000 tons from the SGR were exported.

The government collected about MK 1.4 billion from maize sales during 2003/04. This recovers only a portion of the MK 7.4 billion (4¾ percent of GDP) cost of the maize operation during FY 2002/03. The difference is mainly explained by (a) the distribution of subsidized maize (the government was paid MK 6 per kilogram sold through ADMARC) and (b) the selling of maize at an average price of MK 10 per kilogram to parties other than ADMARC.

For the fiscal year 2004/05, the government has committed to replenish the SGR with 60,000 tons. In addition to SGR maize, the use of which is restricted by agreement with donors, the government has decided to purchase up to 70,000 tons of maize that would be sold through commercial channels. It is hoped that the availability of this stock in the country will help stabilize the domestic maize market and avoid the price spikes seen during the maize shortage in 2002.

The cost to replenish the SGR in 2004/05 is estimated at MK 1.4 billion (1/2 percent of GDP), about one-half of which will come from the European Union. The government has committed to spend no more than MK 1.5 billion for the commercial maize purchases, and with the assumption that this maize will be sold for MK 17 per kilogram, the net cost to the government would be limited to about MK 800 million.

The role of ADMARC in the domestic maize market has been reformed. The government has made a commitment to provide no further subsidies to cover operational expenses of ADMARC. However, this year budget includes MK 800 to cover restructuring costs and MK 400 million to subsidize the social functions of ADMARC. The World Bank will assist with ADMARC restructuring under the Structural Adjustment Credit that was approved in April 2004.

IV. Technical Assistance and Data Issues

44. **Economic data show serious deficiencies**. In particular, the national accounts are very likely to understate domestic investment and foreign financed development spending is underreported. The Data Module Report on the Observance of Standards and Codes found that, while the institutional framework for the production of macroeconomic statistics was broadly adequate, there are shortcomings in the scope, accuracy, and reliability of data. The authorities are making efforts to improve the quality and timeliness of the statistical data. Malawi is a participant in the GDDS and receives technical assistance under the project for Anglophone African countries that is sponsored by DIFD.

45. **Malawi has received significant technical assistance from the Fund (Appendix I).** The RBM has benefited from advice in monetary operations, payment systems, and banking supervision, but implementation has been slow in some cases. The authorities have requested, and the staff intends to provide, further assistance in tax administration and expenditure management. The staff is working closely with Malawi's other development partners, especially in the area of expenditure management.

V. Staff Appraisal

46. **Since the 2002 Article IV consultation, Malawi has recovered from a severe drought and food emergency, but now finds itself in a precarious macroeconomic situation.** Above budget spending and delays in donor assistance over much of the past two years have left Malawi with an unsustainable level of domestic debt, high interest rates, and eroded private sector confidence. Fortunately, there are now tentative signs that Malawi is turning the corner.

47. **The new government has demonstrated its determination to act decisively**. It met its budgetary targets for end-June and July and is on course to meet quantitative targets for end-September under the SMP. Parliament has approved the 2004/05 budget that is in line with the SMP and, if fully implemented, would sharply reduce domestic borrowing. Quantification of already adopted savings measures such as the reduction in the number of ministries will be needed at the midterm review.

48. **The SMP focus on the implementation of sound fiscal policies is crucial for restoring macroeconomic stability and reducing the volatility in external aid.** In this context, the staff welcomes the government's commitment to strictly limit domestic borrowing to 2 percent of GDP in FY2004/05, while including room for priority expenditures on wage reform and food security.

49. **An active monetary policy continues to be essential for containing emerging inflationary pressures.** The RBM will need to remain vigilant and mop up the monetary overhang that was injected into the economy during 2003-04. The staff welcomes the RBMs willingness to tighten policies if high rates of monetary growth persist. The market determined exchange rate has remained stable for almost one year, but low international reserves and the end of the tobacco marketing season could put pressure on the exchange rate.

50. **Food security is a critical issue in Malawi, and the country is facing a possible maize shortage this year**. The 2004/05 budget contains provisions to replenish the strategic grain reserve and purchase maize for distribution through commercial channels later in the year. The government has also appealed to the international community for assistance to supplement its efforts. In addition, the budget includes a fertilizer targeted to poor households. The staff welcomes the inclusion of these initiatives in the budget as well as plans to address medium-term agricultural sustainability.

51. **Implementation of structural reforms has recently regained momentum and will soon begin to pay off.** The long planned civil service pay restructuring is about to be implemented, and a new, more targeted role for ADMARC is expected soon. Other achievements, including progress in the audit of domestic arrears and passage of legislation to strengthen financial management, will also contribute to a more efficient government.

52. **Improvements in public expenditure management are of prime importance**. They are needed, first, to ensure that the government achieves its policy objectives within the resources available and, second, to facilitate budget monitoring by the government itself, but also parliament and other stakeholders. The staff welcomes the government's commitment to steadfast implementation of the approved budget, strengthened enforcement of budget procedures, and plans to rebuild capacity in these areas. Specific measures are included in the SMP. Moreover, the authorities have requested technical assistance in this area.

53. **Good governance is critical to Malawi's economic success.** The recent passage of financial management legislation and amendments to the Anti-Corruption Act is important steps in this direction. The staff commends the government on its recent actions to address corruption at the highest levels.

54. **Improving the lives of all Malawians remains the overriding goal for economic policies.** The challenges facing Malawi are vast; widespread income poverty, low levels of human capital, limited domestic resources and a high incidence of HIV/AIDS. Implementation of MPRS during the first year was below expectations with insufficient public funding of pro-poor expenditures. The staff supports the emerging medium-term growth strategy, in particular its emphasis on the private sector. It also agrees with the authorities that achieving macroeconomic stability in the very near term is a prerequisite to economic growth and poverty reduction.

55. **The conclusions reached by the EPA provide a good guideline for future Fund engagement.** Lack of ownership and capacity has had a detrimental impact on the implementation of economic policy and structural reforms. Recent efforts by the government are a welcome sign of change, as are plans to strengthen capacity at the Ministry of Finance. The staff is hopeful that the SMP will provide an opportunity for the authorities to demonstrate budget discipline and the ability to achieve targets under their economic program. The structural objectives in the SMP have been limited as recommended by the EPA.

56. **While risks remain substantive, staff considers the current economic program, with focus on macroeconomic stabilization and strengthening of the expenditure control management, to be appropriate.** As recommended in the ex post assessment, a new PRGF arrangement would depend on a period of success in meeting program targets, with the length of the period of demonstrated commitment balancing against Malawi's need for balance of payments assistance. In the staff's view, strong performance relative to the end-September and end-December targets in the SMP would be an appropriate balance. Other

considerations are approval of the EPA report's conclusion that a new arrangement would be beneficial and a positive assessment of the program's future success.

57. Timely provision of reliable economic and financial data is essential for effective macroeconomic management and Fund surveillance. The staff welcomes recent improvements, and urges the authorities to strengthen further the statistical base.

58. It is recommended that the next Article IV consultation with Malawi be held within 24 months if a new PRGF arrangement is put in place, or otherwise on the standard 12-month cycle.

Table 1. Malawi: Selected Economic and Financial Indicators, 2001-05

	2001	2002	2003	2004		2005
	Act.	Prel.	Est.	Prog.	Proj.	Proj.
	(Percentage change, unless otherwise indicated)					
GDP and prices						
GDP at constant market prices	-4.1	1.9	4.4	5.0	3.9	4.2
Consumer prices (end of period)	22.1	7.6	9.8	5.5	20.0	10.0
Consumer prices (annual average)	27.2	14.9	9.6	7.3	14.9	15.0
GDP deflator	24.8	13.1	11.2	6.2	14.7	14.2
Interest rates (end of period) 1/	50.4	40.8	37.0	…	...	…
Nominal effective exchange rate (end period) 2/	39.3	-30.8	-18.0	…	…	…
Real effective exchange rate (end period) 2/	56.0	-35.3	-16.6	…	…	…
External sector						
Exports, f.o.b. (millions of U.S. dollars)	426.6	421.1	402.1	466.5	476.4	484.1
Imports, c.i.f. (millions of U.S. dollars)	584.5	726.8	629.6	626.4	703.0	693.3
Terms of trade	-0.3	-7.5	-7.9	3.0	-0.8	-1.0
Money and credit 3/						
Money and quasi money	21.2	25.2	29.3	10.0	25.5	14.8
Net foreign assets	-8.0	-55.4	21.5	24.6	1.8	8.0
Net domestic assets	29.2	80.6	7.8	-14.6	23.8	6.8
Credit to the government	29.4	45.1	11.3	-20.6	36.4	5.2
Credit to the rest of the economy	-2.9	4.1	8.1	7.7	1.2	7.3
	(Percent of GDP, unless otherwise indicated)					
Central government 4/						
Revenue (excluding grants)	17.2	20.7	23.5	…	24.0	23.7
Expenditure	31.9	39.7	43.3	…	40.0	38.3
Underlying balance 5/	-2.8	-1.8	-0.9	…	1.2	1.6
Primary balance	-2.8	-5.0	3.7	…	4.7	5.5
Overall balance (cash basis, including grants)	-7.9	-12.1	-7.3	…	-4.3	-2.7
National saving	7.1	-1.0	2.4	5.6	1.9	3.7
Domestic saving	2.7	-12.0	-5.0	0.0	-3.5	-1.0
Net factor income	-1.9	-2.4	-2.4	-2.3	-2.2	-1.9
Unrequited transfers	6.3	13.4	9.8	7.9	7.6	6.6
Net official transfers	5.7	12.6	9.0	7.3	6.9	5.9
Net private transfers	0.6	0.8	0.7	0.6	0.7	0.7
Gross investment	13.9	10.9	11.2	11.5	11.2	11.8
Public	10.4	8.0	9.7	9.7	9.3	9.2
Private	2.4	1.8	0.6	1.8	1.0	1.7
Stock building	1.1	1.0	0.9	0.0	0.9	0.8
External sector						
Exports, f.o.b.	25.0	22.6	23.6	25.7	26.7	25.1
Imports, c.i.f.	34.3	39.0	37.0	34.5	39.4	36.0
External current account (including official transfers)	-6.8	-11.9	-8.8	-5.9	-9.2	-8.1
External debt	160.5	148.8	166.3	160.7	160.7	151.7
Debt-service ratio 6/	20.0	20.3	23.5	21.4	21.1	21.0
Of which : interest payments 6/	6.3	6.2	6.6	5.6	5.4	5.2
	(In millions of U.S. dollars, unless otherwise indicated)					
Usable gross official reserves 7/						
End-period stock	184.6	103.4	115.6	180.5	84.8	104.1
In months of imports of goods and nonfactor services 8/	2.7	1.7	1.8	2.8	1.3	1.6
External debt (disbursed and outstanding, end of period)	2,736	2,773	2,831	2,922	2,870	2,919
Memorandum items:						
GDP (in millions of kwacha)	123,080	142,928	165,751	184,100	197,370	234,889
Net domestic debt (in percent of GDP)						
Central government	7.4	18.1	23.2	…	27.4	25.2
Public sector 9/	10.7	15.4	19.9	…	22.6	22.1
Kwacha per U.S. dollar exchange rate (period average)	72.2	76.7	97.4	…	…	…
Per capita GDP (U.S. dollars)	162.0	173.5	155.3	…	…	…
Population (millions)	10.5	10.7	11.0	11.2	11.2	11.4

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

1/ Compounded three-month treasury bill interest rate.

2/ Positive value denotes appreciation of kwacha.

3/ Change in percent of money and quasi money at the beginning of the period.

4/ Fiscal year starting July 1; information for 2001 refers to FY 2001/02 etc.

5/ This is a measure of domestic primary balance: overall balance plus statistical discrepancy, excluding grants, revenue from maize, total interest, expenditure for maize, and foreign financed development expenditures.

6/ In percent of exports of goods and nonfactor services. Excludes debt relief.

7/ Excludes open letter of credit for 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.

8/ In percent of imports of goods and nonfactor services in the following period.

9/ Private sector holdings of central government debt and RBM bills.

Table 2. Malawi: Central Government Operations, 2001/02 - 2004/05

	FY 2001/02	FY 2002/03	FY 2003/04		FY 2004/05
	Est.	Est. 1/	Prog.	Est.	Proj.
	(In millions of MWI kwacha)				
Total revenue and grants	31,997	42,685	60,663	65,365	77,094
Revenue	22,853	32,009	37,992	42,754	51,881
Tax revenue	20,382	27,251	31,953	36,902	44,747
Taxes on income and profits	9,458	12,146	14,108	15,839	19,854
Taxes on goods and services	8,935	12,379	14,704	16,634	19,996
Taxes on international trade	2,423	3,136	3,607	5,082	5,897
Other (incl. refunds)	-435	-410	-466	-653	-1,001
Nontax revenue	2,471	4,758	4,339	5,852	7,135
Departmental receipts	1,141	1,614	2,420	2,237	2,440
Petroleum levy for NRA	1,113	1,222	1,391	1,285	1,482
Petroleum levy for safety nets	169	464	528	884	1,052
Sale receipts from maize (from NFRA)	...	591	0	1,351	2,160
Dividends	49	868	0	95	0
Revenue measures 2/	...	...	1,700	...	...
Grants	9,144	10,675	22,671	22,611	25,212
Program	2,544	1,220	8,177	4,580	5,418
Food security program	581	188	0	0	0
Partially tied grants	...	...	...	903	0
EDRC	...	...	...	1,090	0
Project	3,479	4,604	5,835	9,635	13,799
Financing of elections	...	...	480	653	0
HIPC Initiative debt relief	1,718	3,588	6,836	5,261	5,995
Japanese debt relief	821	1,075	1,344	490	0
Total expenditure and net lending	42,490	61,322	61,517	78,598	86,351
Total expenditure	42,490	61,260	61,517	78,598	86,351
Current expenditure	32,675	49,473	48,143	58,086	67,403
Wages and salaries	9,201	10,930	11,444	12,302	15,300
Interest payments	6,820	10,985	16,682	20,024	19,427
Domestic	5,242	8,871	13,985	17,253	16,863
Foreign	1,578	2,114	2,697	2,771	2,565
Other current expenditure	16,654	27,559	20,018	25,761	32,676
Goods and services	11,111	20,127	13,398	16,902	20,097
Of which: maize purchase	...	6,078	0	0	2,890
Subsidies and other current transfers	5,543	7,431	6,420	7,510	12,080
Expenditure for arrears	0	0	200	1,349	500
Expenditure measures 2/ 3/	...	0	-3,334	...	...
Development expenditure	9,816	11,787	16,708	20,512	18,947
Part I (foreign-financed)	7,761	9,521	14,175	17,231	16,804
Part II (domestically financed)	2,055	2,266	2,533	3,281	2,143
Overall balance (including grants)	-10,493	-18,637	-854	-13,233	-9,257
Total financing	9,148	18,099	3,085	14,938	9,257
Foreign (net)	-268	-730	8,424	425	5,063
Borrowing	4,282	4,917	15,287	7,185	11,215
Program	0	0	6,947	0	7,921
EDRC	0	0	0	1,386	514
Project	4,282	4,917	8,340	5,799	2,781
Amortization	-3,510	-5,448	-6,479	-7,577	-8,428
Special loans (net)	-332	-323	0	0	889
Japanese debt relief account	-708	125	-384	759	1,200
EU food security account	...	...	...	...	700
WB EDRC accounts (NY)	...	...	...	58	-514
Domestic (net)	9,416	18,829	-5,339	14,512	4,194
Statistical discrepancy	1,346	538	-2,231	-1,704	0
Memorandum items:					
Net domestic debt (T-bills are valued at cost)	13,518	32,654	27,315	47,104	51,298
Program support and HIPC Initiative debt relief	4,263	4,808	21,959	9,841	19,334
Primary balance (including grants)	-3,673	-7,652	15,828	6,790	10,170
Underlying balance 4/	-3,711	-2,781	5,100	-1,645	2,492

Table 2. Malawi: Central Government Operations, 2001/02 - 2004/05 (concluded)

	FY 2001/02	FY 2002/03	FY 2003/04		FY 2004/05
	Est.	Est. 1/	Prog.	Est.	Proj.
			(In percent of GDP)		
Total revenue and grants	24.1	27.7	34.7	36.0	35.7
Revenue	17.2	20.7	21.8	23.5	24.0
Tax revenue	15.3	17.7	18.3	20.3	20.7
Taxes on income and profits	7.1	7.9	8.1	8.7	9.2
Taxes on goods and services	6.7	8.0	8.4	9.2	9.3
Taxes on international trade	1.8	2.0	2.1	2.8	2.7
Other (incl. refunds)	-0.3	-0.3	-0.3	-0.4	-0.5
Nontax revenue	1.9	3.1	2.5	3.2	3.3
Departmental receipts	0.9	1.0	1.4	1.2	1.1
Petroleum levy for NRA	0.8	0.8	0.8	0.7	0.7
Petroleum levy for safety nets	0.1	0.3	0.3	0.5	0.5
Sale receipts from maize (from NFRA)	...	0.4	0.0	0.7	1.0
Dividends	0.0	0.6	0.0	0.1	0.0
Revenue measures 2/	...	...	1.0	...	...
Grants	6.9	6.9	13.0	12.5	11.7
Program	1.9	0.8	4.7	2.5	2.5
Food security program	0.4	0.1	0.0	0.0	0.0
Partially tied grants	...	...	...	0.5	0.0
EDRC	...	...	...	0.6	0.0
Project	2.6	3.0	3.3	5.3	6.4
Financing of Elections	...	...	0.3	0.4	0.0
HIPC Initiative debt relief	1.3	2.3	3.9	2.9	2.8
Japanese debt relief	0.6	0.7	0.8	0.3	0.0
Total expenditure and net lending	31.9	39.7	35.2	43.3	40.0
Total expenditure	31.9	39.7	35.2	43.3	40.0
Current expenditure	24.6	32.1	27.6	32.0	31.2
Wages and salaries	6.9	7.1	6.6	6.8	7.1
Interest payments	5.1	7.1	9.6	11.0	9.0
Domestic	3.9	5.7	8.0	9.5	7.8
Foreign	1.2	1.4	1.5	1.5	1.2
Other current expenditure	12.5	17.9	11.5	14.2	15.1
Goods and services	8.4	13.0	7.7	9.3	9.3
Of which: maize purchase	...	3.9	0.0	0.0	1.3
Subsidies and other current transfers	4.2	4.8	3.7	4.1	5.6
Expenditure for arrears	0.0	0.0	0.1	0.7	0.2
Expenditure measures 2/ 3/	...	0.0	-1.9	...	...
Development expenditure	7.4	7.6	9.6	11.3	8.8
Part I (foreign-financed)	5.8	6.2	8.1	9.5	7.8
Part II (domestically financed)	1.5	1.5	1.5	1.8	1.0
Net lending	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	-7.9	-12.1	-0.5	-7.3	-4.3
Total financing	6.9	11.7	1.8	8.2	4.3
Foreign (net)	-0.2	-0.5	4.8	0.2	2.3
Borrowing	3.2	3.2	8.8	4.0	5.2
Program	0.0	0.0	4.0	0.0	3.7
EDRC	0.0	0.0	0.0	0.8	0.2
Project	3.2	3.2	4.8	3.2	1.3
Amortization	-2.6	-3.5	-3.7	-4.2	-3.9
Special loans (net)	-0.2	-0.2	0.0	0.0	0.4
Japanese debt relief account	-0.5	0.1	-0.2	0.4	0.6
EU food security account	...	...	...	...	0.3
WB EDRC accounts (NY)	...	...	...	0.0	-0.2
Domestic (net)	7.1	12.2	-3.1	8.0	1.9
Statistical discrepancy	1.0	0.3	-1.3	-0.9	0.0
Memorandum items:					
Net domestic debt (T-bills valued at cost)	10.2	21.2	15.6	25.9	23.7
Overall balance (excluding grants)	-14.8	-19.0	-13.5	-19.7	-15.9
Primary balance (including grants)	-2.8	-5.0	9.1	3.7	4.7
Underlying balance 4/	-2.8	-1.8	2.9	-0.9	1.2
Program support plus HIPC Initiative debt relief	3.2	3.1	12.6	5.4	8.9
Nominal GDP	133,004	154,340	174,600	181,560	216,129

Sources: Malawian authorities; and Fund staff projections.

1/ Includes the 2002/03 maize operation (in contrast to presentation in IMF Country Report No. 03/344).

2/ For FY 2003/04 estimates, any measure taken is included in the appropiate category.

3/ For the 2003/04 program it was expected that these savings would result from a reduction of the travel budget, nonfilling of vacancies, a freeze on promotions, the postponement of new domestically financed development expenditure, and additional postponement of discretionary outlays.

4/ Defined as overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize, plus foreign-financed development expenditures.

Table 3. Malawi: Central Government Operations, 2003/04 - 2004/05

	FY 2003/04					FY 2004/05				
	QI Est.	QII Est.	QIII Proj.	QIV Proj.	FY Proj.	QI Proj.	QII Proj.	QIII Proj.	QIV Proj.	FY Proj.
	(In millions of MWI kwacha)									
Total revenue and grants	14,352	18,112	19,078	13,823	65,365	15,489	20,820	20,481	20,304	77,094
Revenue	9,959	10,466	10,936	11,393	42,754	11,419	12,210	14,467	13,785	51,881
Tax revenue	8,631	8,703	9,258	10,309	36,902	10,323	10,688	11,390	12,345	44,747
Taxes on income and profits	3,616	3,545	4,121	4,557	15,839	4,374	5,025	4,928	5,528	19,854
Taxes on goods and services	3,899	4,160	4,076	4,499	16,634	4,775	4,600	5,180	5,442	19,996
Taxes on international trade	1,245	1,140	1,209	1,488	5,082	1,422	1,318	1,535	1,622	5,897
Other (incl. refunds)	-129	-141	-148	-234	-653	-248	-255	-252	-246	-1,001
Nontax revenue	1,327	1,762	1,678	1,084	5,852	1,096	1,521	3,077	1,440	7,135
Departmental receipts	568	577	546	546	2,237	463	537	634	806	2,440
Petroleum levy for NRA	330	371	308	277	1,285	371	371	371	371	1,482
Petroleum levy for safety nets	201	175	364	144	884	263	263	263	263	1,052
Sale receipts from maize (from NFRA)	229	640	460	22	1,351	0	351	1,809	0	2,160
Grants	4,393	7,647	8,142	2,429	22,611	4,070	8,610	6,014	6,519	25,212
Program	0	1,517	3,063	0	4,580	0	3,785	1,081	553	5,418
Partially tied grants	0	903	0	0	903	0	0	0	0	0
EDRC	790	147	152	0	1,090	0	0	0	0	0
Project	2,393	3,124	3,561	557	9,635	2,760	3,450	3,450	4,140	13,799
Financing of elections	0	87	27	539	653	0	0	0	0	0
HIPC Initiative debt relief	1,210	1,379	1,338	1,334	5,261	1,310	1,376	1,483	1,826	5,995
Japanese debt relief	0	490	0	0	490	0	0	0	0	0
Total expenditure	18,762	19,106	19,044	21,686	78,598	20,622	24,001	21,170	20,558	86,351
Current expenditure	14,523	12,416	13,063	18,084	58,086	16,698	19,215	16,482	15,008	67,403
Wages and salaries	2,961	2,976	3,132	3,233	12,302	3,400	3,900	3,936	4,064	15,300
Interest payments	5,287	4,580	5,199	4,957	20,024	5,518	3,995	5,144	4,771	19,427
Domestic	4,718	3,826	4,520	4,188	17,253	4,932	3,317	4,547	4,066	16,863
Foreign	570	753	679	769	2,771	586	678	596	704	2,565
Other current expenditure	6,275	4,860	4,732	9,894	25,761	7,780	11,321	7,402	6,173	32,676
Goods and services	4,075	2,967	2,894	6,965	16,902	5,176	6,322	4,233	4,365	20,097
Of which: maize purchases	0	0	0	0	0	1,390	1,500	0	0	2,890
Subsidies and other current transfers	1,782	1,889	1,711	2,128	7,510	2,604	4,832	3,002	1,642	12,080
Expenditure for arrears	418	4	127	800	1,349	0	167	167	167	500
Development expenditure	4,238	6,690	5,981	3,603	20,512	3,924	4,785	4,688	5,550	18,947
Part I (foreign-financed)	3,859	6,090	5,643	1,639	17,231	3,427	4,259	4,145	4,974	16,804
Part II (domestically financed)	380	600	338	1,963	3,281	498	527	543	576	2,143
Overall balance (including grants)	-4,410	-993	34	-7,864	-13,233	-5,133	-3,181	-689	-254	-9,257
Total financing	4,459	2,134	520	7,824	14,938	5,133	3,181	689	254	9,257
Foreign (net)	377	411	441	-804	425	-927	2,531	1,153	2,307	5,063
Borrowing	1,624	2,591	2,109	861	7,185	888	3,722	2,736	3,870	11,215
Program	0	0	0	0	0	0	2,844	2,041	3,035	7,921
EDRC	372	360	326	327	1,386	332	182	0	0	514
Project	1,252	2,231	1,783	534	5,799	556	695	695	834	2,781
Amortization	-1,535	-2,141	-2,091	-1,810	-7,577	-2,783	-1,920	-1,869	-1,856	-8,428
Special loans (net)	0	0	0	0	0	0	311	285	293	889
Japanese debt relief account	379	-252	375	257	759	600	600	0	0	1,200
EU food security account	...	...	...	...	...	700	0	0	0	700
WB EDRC accounts (NY)	-91	213	48	-112	58	-332	-182	0	0	-514
Domestic (net)	4,082	1,723	79	8,628	14,512	6,060	651	-464	-2,053	4,194
Statistical discrepancy	-49	-1,140	-554	39	-1,704	0	0	0	0	0
Memorandum items:										
Net domestic debt (T-bills valued at cost)	36,674	38,397	38,476	47,104	47,104	53,165	53,815	53,351	51,298	51,298
Program support and HIPC Initiative debt relief	1,210	2,896	4,402	1,334	9,841	1,310	8,005	4,605	5,414	19,334
Primary balance (including grants)	877	3,586	5,233	-2,906	6,790	385	814	4,455	4,517	10,170
Underlying balance	65	248	1,721	-3,679	-1,645	1,132	-2,389	777	2,972	2,492

Table 3. Malawi: Central Government Operations, 2003/04 - 2004/05 (concluded)

	FY 2003/04					FY 2004/05				
	QI Est.	QII Est.	QIII Proj.	QIV Proj.	FY Proj.	QI Proj.	QII Proj.	QIII Proj.	QIV Proj.	FY Proj.
	(In percent of GDP)									
Total revenue and grants	7.9	10.0	10.5	7.6	36.0	7.2	9.6	9.5	9.4	35.7
Revenue	5.5	5.8	6.0	6.3	23.5	5.3	5.6	6.7	6.4	24.0
Tax revenue	4.8	4.8	5.1	5.7	20.3	4.8	4.9	5.3	5.7	20.7
Taxes on income and profits	2.0	2.0	2.3	2.5	8.7	2.0	2.3	2.3	2.6	9.2
Taxes on goods and services	2.1	2.3	2.2	2.5	9.2	2.2	2.1	2.4	2.5	9.3
Taxes on international trade	0.7	0.6	0.7	0.8	2.8	0.7	0.6	0.7	0.8	2.7
Other (incl. refunds)	-0.1	-0.1	-0.1	-0.1	-0.4	-0.1	-0.1	-0.1	-0.1	-0.5
Nontax revenue	0.7	1.0	0.9	0.6	3.2	0.5	0.7	1.4	0.7	3.3
Departmental receipts	0.3	0.3	0.3	0.3	1.2	0.2	0.2	0.3	0.4	1.1
Petroleum levy for NRA	0.2	0.2	0.2	0.2	0.7	0.2	0.2	0.2	0.2	0.7
Petroleum levy for safety nets	0.1	0.1	0.2	0.1	0.5	0.1	0.1	0.1	0.1	0.5
Sale receipts from maize (from NFRA)	0.1	0.4	0.3	0.0	0.7	0.0	0.2	0.8	0.0	1.0
Grants	2.4	4.2	4.5	1.3	12.5	1.9	4.0	2.8	3.0	11.7
Program	0.0	0.8	1.7	0.0	2.5	0.0	1.8	0.5	0.3	2.5
Partially tied grants	0.0	0.5	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0
EDRC	0.4	0.1	0.1	0.0	0.6	0.0	0.0	0.0	0.0	0.0
Project	1.3	1.7	2.0	0.3	5.3	1.3	1.6	1.6	1.9	6.4
Financing of elections	0.0	0.0	0.0	0.3	0.4	0.0	0.0	0.0	0.0	0.0
HIPC Initiative debt relief	0.7	0.8	0.7	0.7	2.9	0.6	0.6	0.7	0.8	2.8
Japanese debt relief	0.0	0.3	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Total expenditure	10.3	10.5	10.5	11.9	43.3	9.5	11.1	9.8	9.5	40.0
Current expenditure	8.0	6.8	7.2	10.0	32.0	7.7	8.9	7.6	6.9	31.2
Wages and salaries	1.6	1.6	1.7	1.8	6.8	1.6	1.8	1.8	1.9	7.1
Interest payments	2.9	2.5	2.9	2.7	11.0	2.6	1.8	2.4	2.2	9.0
Domestic	2.6	2.1	2.5	2.3	9.5	2.3	1.5	2.1	1.9	7.8
Foreign	0.3	0.4	0.4	0.4	1.5	0.3	0.3	0.3	0.3	1.2
Other current expenditure	3.5	2.7	2.6	5.4	14.2	3.6	5.2	3.4	2.9	15.1
Goods and services	2.2	1.6	1.6	3.8	9.3	2.4	2.9	2.0	2.0	9.3
Of which: maize purchases	0.0	0.0	0.0	0.0	0.0	0.6	0.7	0.0	0.0	1.3
Subsidies and other current transfers	1.0	1.0	0.9	1.2	4.1	1.2	2.2	1.4	0.8	5.6
Expenditure for arrears	0.2	0.0	0.1	0.4	0.7	0.0	0.1	0.1	0.1	0.2
Development expenditure	2.3	3.7	3.3	2.0	11.3	1.8	2.2	2.2	2.6	8.8
Part I (foreign-financed)	2.1	3.4	3.1	0.9	9.5	1.6	2.0	1.9	2.3	7.8
Part II (domestically financed)	0.2	0.3	0.2	1.1	1.8	0.2	0.2	0.3	0.3	1.0
Overall balance (including grants)	-2.4	-0.5	0.0	-4.3	-7.3	-2.4	-1.5	-0.3	-0.1	-4.3
Total financing	2.5	1.2	0.3	4.3	8.2	2.4	1.5	0.3	0.1	4.3
Foreign (net)	0.2	0.2	0.2	-0.4	0.2	-0.4	1.2	0.5	1.1	2.3
Borrowing	0.9	1.4	1.2	0.5	4.0	0.4	1.7	1.3	1.8	5.2
Program	0.0	0.0	0.0	0.0	0.0	0.0	1.3	0.9	1.4	3.7
EDRC	0.2	0.2	0.2	0.2	0.8	0.2	0.1	0.0	0.0	0.2
Project	0.7	1.2	1.0	0.3	3.2	0.3	0.3	0.3	0.4	1.3
Amortization	-0.8	-1.2	-1.2	-1.0	-4.2	-1.3	-0.9	-0.9	-0.9	-3.9
Special loans (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.4
Japanese debt relief account	0.2	-0.1	0.2	0.1	0.4	0.3	0.3	0.0	0.0	0.6
EU food security account	...	...	...	...	...	0.3	0.0	0.0	0.0	0.3
WB EDRC accounts (NY)	-0.1	0.1	0.0	-0.1	0.0	-0.2	-0.1	0.0	0.0	-0.2
Domestic (net)	2.2	0.9	0.0	4.8	8.0	2.8	0.3	-0.2	-0.9	1.9
Statistical discrepancy	0.0	-0.6	-0.3	0.0	-0.9	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Net domestic debt (T-bills valued at cost)	20.2	21.1	21.2	25.9	25.9	24.6	24.9	24.7	23.7	23.7
Program support plus HIPC Initiative debt relief	0.7	1.6	2.4	0.7	5.4	0.6	3.7	2.1	2.5	8.9
Overall balance (excluding grants)	-4.8	-4.8	-4.5	-5.7	-19.7	-4.3	-5.5	-3.1	-3.1	-15.9
Primary balance (including grants)	0.5	2.0	2.9	-1.6	3.7	0.2	0.4	2.1	2.1	4.7
Underlying balance	0.0	0.1	0.9	-2.0	-0.9	0.5	-1.1	0.4	1.4	1.2
Nominal GDP	181,560	181,560	181,560	181,560	181,560	216,129	216,129	216,129	216,129	216,129

Sources: Malawian authorities; and Fund staff projections.

Table 4. Malawi : Monetary Authorities' Balance Sheet, 2002-05
(In millions of Malawi kwacha, unless otherwise indicated)

	2002				2003				2004			Projections 2004		Projections 2005	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2 Prog.	Q2 Act.	Q3 Proj.	Q4 Proj.	Q1 Proj.	Q2 Proj.
Reserve money 1/	7,245	8,877	9,879	10,682	8,717	9,836	12,846	13,743	12,058	12,393	18,723	18,800	17,193	14,864	18,674
Currency outside banks	4,306	6,067	6,226	5,964	5,558	7,827	8,160	7,838	7,211	...	11,072	...	...	...	...
Cash in vault	509	683	852	1,101	909	1,079	1,173	1,449	1,382	...	1,418	...	...	...	...
Commercial bank deposits with RBM	2,430	2,128	2,801	3,617	2,250	930	3,512	4,455	3,465	...	6,233	...	...	...	...
Net foreign assets (NFA)	3,998	7,194	1,531	-3,558	-4,467	-330	-1,210	1,455	698	7,852	-8	-1,275	-322	-1,472	3,685
NFA (in millions of U.S. dollars)	50.9	93.9	19.0	-40.8	-48.8	-3.7	-11.2	13.4	6.4	87.3	-0.1	-11.7	-3.0	-13.5	33.8
Gross foreign assets	124.9	167.1	114.0	103.4	85.0	89.8	81.2	115.6	106.3	185.5	93.6	81.3	84.8	73.1	114.1
Foreign liabilities	-74.0	-73.3	-95.0	-144.2	-133.7	-93.4	-92.4	-102.2	-99.9	-98.2	-93.7	-93.0	-87.8	-86.6	-80.2
Net domestic assets	3,247	1,683	8,348	14,239	13,184	10,166	14,056	12,288	11,360	4,541	18,731	20,075	17,515	16,336	14,988
Credit to government (net)	4,313	1,386	4,661	9,666	11,334	10,613	10,487	8,245	9,323	7,986	17,215	19,815	20,466	20,002	17,949
Credit to statutory bodies (net)	314	314	314	0	0	0	0	0	0	0	0	0	0	0	0
Credit to domestic banks	3	6	3	3	118	3	138	3	3	4	2	3	3	3	3
Other items (net)	-1,383	-22	3,370	4,570	1,731	-450	3,431	4,039	2,034	-3,448	1,514	257	-2,954	-3,669	-2,964
Revaluation accounts	198	254	451	-4	170	-337	-119	0	10	-3,513	0	0	0	0	0
Open market operations	-5,908	-6,621	-7,201	-5,850	-7,018	-9,212	-4,566	-2,914	-5,233	-11,379	-5,199	-6,816	-9,635	-10,070	-8,990
Encumbered reserves	1,306	2,001	6,513	5,105	2,998	1,784	1,989	759	761	1,744	305	1,013	1,013	1,013	1,013
Others	3,021	4,344	3,608	5,319	5,581	7,315	6,127	6,194	6,495	9,700	6,408	6,060	5,669	5,388	5,014
Memorandum items:															
Seasonally adjusted reserve money	8,803	8,703	9,406	10,542	10,619	9,595	12,236	13,496	14,707	...	18,191	17,908	16,884	18,129	18,144
Quarterly change	8.3	-1.1	8.1	12.1	0.7	-9.6	27.5	10.3	9.0	...	23.7	-1.6	-5.7	7.4	0.1
Annual change	20.2	13.3	16.3	29.7	20.6	10.2	30.1	28.0	38.5	...	89.6	46.4	25.1	23.3	-0.3
Seasonally adjusted currency outside banks	5,093	5,464	5,814	6,362	6,573	7,049	7,620	8,362	8,529	...	9,972	...	...	...	...
Quarterly change	17.4	7.3	6.4	9.4	3.3	7.3	8.1	9.7	2.0	...	16.9	...	...	...	...
Annual change	12.7	14.5	33.3	46.7	29.1	29.0	31.1	31.4	29.8	...	41.5	...	...	...	...
Money multiplier															
Money multiplier	2.77	2.70	2.57	2.55	3.06	3.20	2.64	2.56	2.97	...	2.28	2.34	2.57	2.84	2.68
Seasonally adjusted	2.53	2.62	2.64	2.58	2.80	3.11	2.70	2.59	2.72	...	2.22	2.40	2.60	2.60	2.60
Net domestic debt															
Central government	12,505	13,518	17,643	25,821	28,734	32,654	36,674	38,397	38,476	...	47,104	53,165	53,815	53,351	51,298
Public sector 2/	14,100	18,753	20,183	22,005	24,417	31,253	30,753	33,065	34,386	...	35,088	40,165	42,985	43,420	42,340
Of which: nonbank holdings	10,069	13,724	14,323	14,703	16,134	21,248	20,345	22,277	23,973	...	25,119	28,434	30,008	30,859	28,593
Net sales															
Quarterly change	1,115	4,653	1,429	1,823	2,412	6,836	-500	2,312	1,321	...	702	5,077	2,820	435	-1,080
Annual change	2,482	5,644	7,197	7,905	5,664	11,071	8,748	8,648	3,133	...	4,335	9,412	9,919	9,034	7,252

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

1/ End-March 2003 and end-June 2003 reserve money figures were low due to RBM intervention just prior to the end of the month.
2/ Private sector holdings of central government debt and RBM bills.

Table 5. Malawi : Monetary Survey, 2002-05 1/
(In millions of Malawi kwacha, unless otherwise indicated)

	2002				2003				2004		Projections 2004		Projections 2005	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Money and quasi-money	20,058	23,983	25,402	27,210	26,641	31,521	33,869	35,183	35,776	42,741	44,044	44,164	42,218	49,998
Money	9,712	12,791	13,213	13,440	13,421	17,154	18,008	17,464	17,012	23,503	...	...	...	...
Quasi-money	10,346	11,192	12,189	13,770	13,220	14,367	15,861	17,718	18,764	19,238	...	...	...	...
Of which: foreign currency deposits	3,094	3,560	3,655	4,505	4,549	4,772	5,886	5,362	7,234	7,719	...	...	...	...
Net foreign assets (NFA)	7,208	11,391	5,222	-380	-489	3,883	3,322	5,466	6,128	6,585	4,911	6,082	4,496	10,960
NFA (in millions of U.S. dollars)	93.8	148.6	65.0	-4.4	-5.3	43.2	30.7	50.4	56.3	60.5	45.1	55.8	41.3	100.6
Gross foreign assets	180.0	237.1	171.3	152.7	137.8	148.3	140.8	167.3	169.7	174.7	156.4	163.9	148.2	201.2
Foreign liabilities	-86.2	-88.5	-106.3	-157.0	-143.1	-105.1	-110.1	-117.0	-113.4	-114.2	-111.3	-108.1	-106.9	-100.5
Monetary authorities	3,998	7,194	1,531	-3,558	-4,467	-330	-1,210	1,455	698	-8	-1,275	-322	-1,472	3,685
NFA of the monetary authorities (in millions of U.S. dollars)	50.9	93.9	19.0	-40.8	-48.8	-3.7	-11.2	13.4	6.4	-0.1	-11.7	-3.0	-13.5	33.8
Gross foreign assets	124.9	167.1	114.0	103.4	85.0	89.8	81.2	115.6	106.3	93.6	81.3	84.8	73.1	114.1
Foreign liabilities	-74.0	-73.3	-95.0	-144.2	-133.7	-93.4	-92.4	-102.2	-99.9	-93.7	-93.0	-87.8	-86.6	-80.2
Commercial banks	3,210	4,197	3,691	3,178	3,978	4,213	4,532	4,011	5,429	6,593	6,186	6,404	5,968	7,275
NFA of the commercial banks (in millions of U.S. dollars)	42.9	54.8	46.0	36.5	43.4	46.9	41.9	36.9	49.8	60.5	56.8	58.8	54.8	66.8
Gross foreign assets	55.1	70.0	57.3	49.3	52.8	58.5	59.6	51.7	63.4	81.1	75.1	79.1	75.1	87.1
Foreign liabilities	-12.2	-15.2	-11.3	-12.8	-9.4	-11.7	-17.7	-14.8	-13.6	-20.6	-18.3	-20.3	-20.3	-20.3
Net domestic assets (NDA)	12,851	12,592	20,180	27,590	27,130	27,638	30,547	29,717	29,649	36,156	39,133	38,083	37,722	39,038
Credit to government (net)	7,372	5,520	9,218	15,626	17,995	19,458	20,410	18,694	19,068	27,023	30,865	31,516	31,052	28,999
Credit to statutory bodies (net)	367	482	152	-120	-588	-698	-266	-352	-222	-720	-752	-786	-814	-842
Credit to private sector	6,998	6,838	6,916	7,363	7,541	9,665	8,888	9,809	9,544	10,459	10,362	10,660	11,923	13,428
Other items (net)	-1,886	-247	3,894	4,721	2,182	-787	1,515	1,566	1,259	-607	-1,342	-3,307	-4,439	-2,547
RBM's revaluation accounts	198	254	451	-4	170	-337	-119	0	10	0	0	0	0	0
Open market operations	-4,961	-5,746	-5,991	-4,508	-5,395	-8,056	-4,080	-2,574	-4,565	-5,039	-6,134	-7,708	-8,560	-6,293
Encumbered reserves	1,306	2,001	6,513	5,105	2,998	1,784	1,989	759	761	305	1,013	1,013	1,013	1,013
Others	1,571	3,243	2,921	4,128	4,409	5,822	3,725	3,381	5,053	4,127	3,779	3,388	3,108	2,733
Memorandum items:														
Seasonally adjusted broad money	21,925	22,911	24,608	27,471	29,120	30,112	32,811	35,520	39,106	40,830	42,667	44,587	46,148	47,763
Quarterly change	0.0	4.5	7.4	11.6	6.0	3.4	9.0	8.3	10.1	4.4	4.5	4.5	3.5	3.5
Annual change	18.3	8.6	21.1	25.2	32.8	31.4	33.3	29.3	34.3	35.6	30.0	25.5	18.0	17.0
Seasonally adjusted credit to private sector	7,027	6,845	7,061	7,212	7,552	9,647	9,072	9,626	9,549	10,437	10,152	10,863	11,916	13,458
Quarterly change	11.3	-2.6	3.1	2.2	4.7	27.7	-6.0	6.1	-0.8	9.3	-2.7	7.0	9.7	12.9
Annual change	28.3	29.1	14.9	14.3	7.5	40.9	28.5	33.5	26.4	8.2	11.9	12.9	24.8	28.9
Velocity of money (annual GDP divided by average broad money)	6.0	5.9	6.1	5.9	5.8	5.6	5.4	5.2	4.8	4.5	4.5	4.7	5.2	5.4

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

1/ Covers four commercial banks (prior tables cover only two banks). Starting in June 2003, data include merger between Stanbic Bank (formerly Commercial Bank of Malawi, CBM) and CBM Financial Services (formerly a nonbank financial institution).

Table 6. Malawi: Balance of Payments, 2001-07

(In millions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004		2005	2006	2007
	Act.	Prel.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
Current account balance (including grants)	-116.5	-221.2	-149.8	-107.7	-165.1	-155.0	-165.7	-198.1
Trade balance	-157.9	-305.7	-227.5	-159.9	-226.6	-209.2	-203.4	-207.9
Exports	426.6	421.1	402.1	466.5	476.4	484.1	499.4	516.5
Imports	-584.5	-726.8	-629.6	-626.4	-703.0	-693.3	-702.7	-724.5
Services balance	-66.3	-165.1	-88.7	-90.8	-74.8	-72.2	-78.6	-81.8
Interest public sector (net)	-17.8	-20.2	-25.5	-24.3	-24.1	-20.2	-22.9	-21.4
Receipts	8.7	2.5	1.5	4.9	1.3	3.5	5.3	5.4
Payments (amounts due before debt relief)	-26.5	-22.7	-27.0	-29.2	-25.4	-23.7	-28.2	-26.8
Other factor payments (net)	-15.3	-24.5	-15.1	-17.4	-15.7	-16.4	-17.1	-18.0
Nonfactor (net)	-33.1	-120.4	-48.1	-49.2	-35.0	-35.7	-38.6	-42.4
Unrequited transfers (net)	107.7	249.6	166.4	143.0	136.3	126.4	116.2	91.7
Private (net)	9.9	14.3	12.4	10.5	12.7	12.9	13.2	13.4
Receipts	21.8	27.7	27.7	23.0	28.2	28.7	29.3	29.9
Payments	-11.8	-13.4	-15.3	-12.5	-15.5	-15.8	-16.1	-16.4
Official (net)	97.7	235.3	154.0	132.5	123.7	113.5	103.1	78.3
Receipts	98.3	235.3	154.0	133.1	123.7	113.5	103.1	78.3
Balance of payments assistance	51.0	12.8	41.7	73.2	62.6	58.5	48.1	28.3
Japan HIPC Initiative 1/	0.0	11.0	16.6	0.0	0.0	0.0	0.0	0.0
Donor humanitarian grants	0.0	135.4	0.0	0.0	0.0	0.0	0.0	0.0
Project related	47.3	76.1	77.7	59.9	61.0	55.0	55.0	50.0
Drought related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Food Security (not yet received in RBM)	0.0	0.0	18.0	0.0	0.0	0.0	0.0	0.0
Payments	-0.6	0.0	0.0	-0.6	0.0	0.0	0.0	0.0
Capital account balance (incl. errors and omissions)	85.0	64.7	102.0	102.6	130.7	121.0	78.0	76.1
Medium- and long-term flows	59.8	23.8	29.5	56.9	56.8	64.6	40.0	40.5
Disbursements	127.0	81.0	115.3	127.4	131.6	133.6	118.4	118.4
Balance of payments support	55.0	0.0	18.4	28.8	35.6	42.6	27.4	27.4
Project support	72.0	81.0	96.9	98.6	86.0	91.0	91.0	91.0
Other medium-term loans	0.0	0.0	0.0	0.0	10.0	0.0	0.0	0.0
Other investment assets	0.0	0.0	-17.2	0.0	2.9	0.0	0.0	0.0
Amortization (amounts due before debt relief)	-67.2	-57.2	-68.6	-70.5	-77.6	-69.0	-78.3	-77.8
Foreign direct investment and other inflows	28.0	37.6	43.2	45.8	44.1	30.9	32.9	35.6
Short-term capital and errors and omissions	-2.8	3.3	29.3	0.0	29.8	25.5	5.0	0.0
Overall balance	-31.5	-156.5	-47.7	-5.1	-34.4	-34.0	-87.7	-122.0
Financing (- increase in reserves)	31.5	156.5	47.8	5.1	34.4	24.1	21.5	27.4
Central bank	11.8	111.4	7.0	-64.8	7.2	-37.3	-29.0	-18.8
Gross reserves (- increase)	40.7	40.8	41.4	-63.0	29.2	-19.3	1.8	-9.3
Liabilities	-28.9	70.6	-34.4	-1.8	-22.0	-18.0	-30.7	-9.5
Of which: IMF (net)	-7.8	15.6	-1.0	-1.9	-14.4	-19.1	-31.9	-9.6
Purchases/drawings	0.0	23.0	9.3	35.1	0.0	0.0	0.0	0.0
Repurchases/repayments	-7.8	-7.4	-10.2	-36.9	-14.4	-19.1	-31.9	-9.6
Bridge loan	0.0	50.0	-50.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	-7.7	14.5	-6.7	-8.0	-21.9	5.0	-9.0	-10.5
Debt relief	27.4	30.6	47.5	77.9	49.1	56.4	59.4	56.7
Residual financing gap (+ underfinanced)	0.0	0.0	0.0	0.0	0.0	9.9	66.2	94.6
Memorandum items:								
Gross official reserves								
In millions of U.S. dollars	202.9	162.1	120.7	199.5	91.5	110.8	109.0	118.3
In months of imports 2/	3.0	2.7	1.8	3.1	1.4	1.7	1.6	1.6
In months of imports 3/	3.6	2.4	2.0	3.3	1.4	1.7	1.6	1.7
Usable gross official reserves 4/								
In millions of U.S. dollars	184.6	103.4	115.6	180.5	84.8	104.1	102.3	111.6
In months of imports 2/	2.7	1.7	1.8	2.8	1.3	1.6	1.5	1.6
In months of imports 3/	3.3	1.5	1.9	3.0	1.3	1.6	1.5	1.6
Current account balance (percent of GDP)								
Excluding official transfers	-12.6	-24.5	-17.8	-13.3	-16.2	-13.9	-13.3	-12.9
Including official transfers	-6.8	-11.9	-8.8	-6.0	-9.2	-8.1	-8.2	-9.3
Export value growth (in percent)	6.2	-1.3	-4.5	7.5	18.5	1.6	3.2	3.4
Import value growth, excluding maize (in percent)	2.3	1.1	6.3	0.4	11.7	-1.4	1.4	3.1

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

1/ For 2002-03, relief was provided through grants in Yens. From 2004 onward, debt will be written off and recorded under debt relief.

2/ In months of following year's imports of goods and nonfactor services.

3/ In months of current year's imports of goods and nonfactor services.

4/ Excludes open letter of credit for 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.

Table 7. Malawi: Millennium Development Goals

	1995	2001	2002
1. Eradicate extreme poverty and hunger (2015 target = $1 a day poverty and malnutrition rates)			
Population below $1 a day (%) 1/	...	...	...
Poverty gap at $1 a day (%) 1/	14.8	...	...
Percentage share of income or consumption held by poorest 20% 2/	4.9	...	...
Prevalence of child malnutrition (% of children under 5)	29.9	25.4	...
Population below minimum level of dietary energy consumption (%)	39.0	33.0	...
2. Achieve universal primary education (2015 target = net enrollment to 100)			
Net Primary Enrollment Rate (% of relevant age group) 3/	99.0	...	...
Percentage of cohort reaching grade 5 (%) 3/	34.2	...	...
Youth literacy rate (% ages 15-24)	67.3	71.8	72.5
3. Promote gender equality (2015 target = education ratio to 100)			
Ratio of girls to boys in primary and secondary education (%)	88.4	...	...
Ratio of young literate females to males (% ages 15-24)	71.4	76.0	76.7
Share of women employed in the nonagricultural sector (%)	11.3	12.2	...
Proportion of seats held by women in national parliament (%)	6	...	...
4. Reduce child mortality (2015 target= reduce 1990 under 5 mortality by two-thirds)			
Under 5 mortality rate (per 1,000)	216	188	182
Infant mortality rate (per 1,000 live births)	133	117	113
Immunization, measles (% of children under 12 months)	90	82	69
5. Improve maternal health (2015 target = reduce 1990 maternal mortality by three-fourths)			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	1,800	...
Births attended by skilled health staff (% of total) 4/	...	55.6	...
6. Combat HIV/AIDS, malaria and other diseases (2015 target = halt, and begin to reverse AIDS etc.)			
Prevalence of HIV, female (% ages 15-24)	...	14.9	...
Contraceptive prevalence rate (% of women ages 15-49) 2/	22.0	30.6	...
Number of children orphaned by HIV/AIDS	...	470,000	...
Incidence of tuberculosis (per 100,000 people)	...	432	431.3
Tuberculosis cases detected under DOTS (%)	39	40	36
7. Ensure environmental sustainability			
Forest area (% of total land area)	...	27.6	...
Nationally protected areas (% of total land area)	11.3	11.3	11.3
GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...
CO2 emissions (metric tons per capita)	0.1	0.1	...
Access to an improved water source (% of population) 4/	...	57	...
Access to improved sanitation (% of population) 4/	...	76	...
Access to secure tenure (% of population)	...	...	...
8. Develop a Global Partnership for Development			
Youth unemployment rate (% of total labor force ages 15-24)	...	...	...
Fixed line and mobile telephones (per 1,000 people)	3.7	10.6	15.2
Personal computers (per 1,000 people)	...	1.3	1.3

Source: *World Development Indicators database, 2004* and *http://www.developmentgoals.org.*

1/ 1998.
2/ 1997.
3/ 1994.
4/ 2000.

Malawi: Ex Post Assessment of Longer-Term Programme Engagement

Authorities' Response

Introduction

The Malawian authorities understand that the ex post assessment has been prepared by the International Monetary Fund against a background of Malawi's persistent failure to implement not only Fund-supported programmes but also its inability to observe budgetary limits. As a matter of fact, the need to choose a government that would instill fiscal discipline became a major issue of the recently-held general election. In consequence, the new administration identified key institutional and procedural obstacles to sound fiscal management and has taken measures of addressing them. For example, the fact that for the past ten years the government had a bloated cabinet of 49 ministers made it difficult for government to prioritize activities. Its activities and development programmes were consistently larger than the available resources. In consequence, extra-budgetary expenditures became routine. Furthermore, the fact that the government operated from two locations, at the capital in Lilongwe and in Blantyre where the President resided, meant that a number of activities and events were duplicated. Thus, each minister and senior official had two residences, offices etc. The huge travel budget reflected daily commuting between the two cities.

Almost immediately on his inauguration, the new President, Dr. Bingu wa Mutharika, decided to relocate the presidency in the capital city of Lilongwe. He also reduced the cabinet from 49 ministers to 20. These two policy decisions have had an immediate impact not only on the budget, but also on the efficiency of the government and the mind set of senior officers on the need to economize resources.

Over and above these decisions, some important obstacles to the implementation of the budgetary process have been identified and addressed. The first relates to issues of governance. Although during the past 10 years, governance surveillance institutions such as the Anti-Corruption Bureau, the office of the Director of Public Prosecution, and the Auditor-General's office were allowed to operate, hardly any prosecutions and convictions of senior officials occurred. However, within the three months of the new government's assumption of office, a number of high profile cases are being held in the courts and in one or two cases convictions have been sustained. This is due to the changes of top level personnel of the institutions and the augmentation of their resources. It is therefore believed that Malawi has now joined a group of African countries that are vigorously eradicating corruption and which are establishing good economic governance.

The government is also reviewing its procurement system. During the last 10 years, in the name of the empowerment of Malawians, a culture emerged whereby rules and regulations pertaining to procurement were relaxed in order to allow middle-men to participate in the procurement of goods and services for the government and parastatals. This became one of the main causes of corruption such as the famous "education scam." The government has halted this policy and has reestablished rules and regulations that allow checks and balances to prevail.

Furthermore, the system whereby ministries were unable to plan on the basis of budgetary allocations and routinely ignored the budgetary framework, has been stopped. Henceforth, ministries are required to work strictly within the budgetary limits and extra-budgetary expenditures have been sharply constrained. As a result, the sanctity of the budget is being strongly enforced as required by the Public Finance Management Act.

For the past five months, these measures have reestablished fiscal discipline and the government was able to observe its fiscal and financial targets, by wide margins in most cases. Thus, it is clear that Malawi has resumed the fiscal discipline that characterized it in the 1970s when it was taunted as one of the best managed economies. It is felt that if the large domestic stock of debt that is dominated by short-term Treasury Bills can be resolved and interest rates were to be lowered, the resulting reduced interest bill of the budget should enable the country to continue with the needed fiscal consolidation and discipline that is being reestablished.

Therefore, in reading the ex-post assessment, it would be fair to bear in mind that the new administration agrees with criticisms that are being leveled, and that long before views of the Fund's ex-post assessment team were known, the Malawi government had already identified the fiscal weaknesses and on its own took measures to address the factors that propelled a culture of fiscal indiscipline. It would also be fair to think of ways that would help the government to sustain the measures that it has taken. In particular, it would be helpful if the Fund were to decide as quickly as possible to resume a PRGF programme after the establishment of the needed track record. The PRGF would anchor the support of the donor community in order that the authorities could be helped to reduce and restructure the domestic debt that has resulted from the past fiscal indiscipline. A prolonged period without the support of the Fund, World Bank and bilateral donors is considered highly unsustainable.

General observations

On the whole, the document ascribes a neutral role to the IMF. It would be fairer that where slippages occurred the responsibility should fall on both, the IMF staff and the authorities. We believe that in certain cases, the staff have demonstrated policy inflexibility, suggesting that in a number of instances, staff positions are defined by their Management in Washington before the mission teams arrive in the country. Consequently, it is sometimes not possible to openly discuss certain positions and have them altered.

In addition, the high turnover of mission chiefs over the review period exacerbated the situation. Every time there was a change of a mission chief, we lost some of the policy foundations that were set by a predecessor. This was particularly true with regards to interest rate policy and projections of the interest bill of the budget.

Other observations

1. **Performance under the PRGF supported programme was poor (Paragraph 13).** Besides, the fiscal laxity that prevailed is a major cause of poor fiscal performance related to the vagaries of donor support that anchored some essential expenditures. The "off and on" donor support led to a large build up of domestic debt and budgetary interest bills. Additionally, during the 2002/2003, maize operations also became a destabilizing factor. Government financed emergency maize operations in the second half of 2002 on the understanding that, as promised, the World Bank and donors would augment central bank foreign exchange reserves expeditiously by providing budget support to the Government. While the IMF responded with speed to the emergency situation, the World Bank responded with considerable delays and some donors opted to finance maize imports directly. The consequence of this development was an unplanned depletion of the central bank's foreign exchange reserves, putting the exchange rate under immense pressure. Government resorted to domestic borrowing to finance these imports, also creating pressure on interest rates.

2. **Monopolies and oligopolies continue to dominate many economic activities, including banking, cement, petroleum, retailing, tobacco auctioning, and transportation (Paragraph 24).** While it is true that the National Bank of Malawi and Stanbic still command almost two thirds of the market, smaller banks such as First Merchant Bank and INDE Bank continue to challenge their dominance. In fact, the number of banks has increased from three to eleven over the span of just ten years**.**

3. **Malawi: Corruption and Governance (Box 3).** As noted above, while it is true that corruption and governance cases grew during the past ten years, issues of governance and corruption are now being addressed through appropriate legislation and institutions, and President Bingu wa Mutharika has adopted a "zero tolerance" stance on corruption. Within a short time, high profile cases are being held in courts of law and already, some "high" people have been convicted.

4. **Progress on structural reforms has also been uneven (Paragraph 41).** This is true but the report omits to inform that in some cases the implementation of structural measures became problematic because the sequencing of reforms was poorly planned. For example, in an effort to control fiscal deficits in the 1980s, subsidies on agricultural inputs were removed without assessing the impact on food security. The cost of emergency maize imports of the 1990's and more recently in 2002 was much higher than the cost of subsidies to the budget. As the EPA report rightly observes, "... elimination of the fertilizer subsidy placed the use of fertilizers beyond the reach of many subsistence farmers". In addition, parastatal reforms were hastily done without the full support of the private sector, resulting in increased unemployment and general insecurity.

5. **Malawi's experience under its Fund-supported programme raises broad issues of programme objectives, programme design, conditionality, and ownership (Paragraph 43).** While the Government of Malawi embraces the objectives of the programme, that is, low interest rates, a stable exchange rate, low inflation, and a growing

economy, we believe programme targets, particularly, structural conditionalities have been too ambitious, at times, and ignored capacity constraints and other realities. For example, the recent Fund supported programme assumed a zero-borrowing target, while at the same time failing to recognize the impact of drought during the programme period and the suspension of donor aid.

6. **Lack of ownership, including and especially at the highest political levels of the country, has resulted in repeated policy slippages, failures to deliver upon agreed policies, and a poor track record (Paragraph 57).** The Government's view is that this conclusion is inappropriate as slippages on fiscal accounts were largely due to higher than anticipated outlays on domestic debt services. This debt was partly a result of non-fulfillment of donor commitments to finance the budget and emergency maize imports. In addition, four out of seven structural conditions were missed because the World Bank failed to act on time.

7. **Ultimately, Malawi's experience with Fund-supported programmes raises issues of selectivity more than of programme design or of conditionality (Paragraph 58).** The linking of donor support to Fund-supported programmes has inevitably meant that the Fund has taken the center stage in programme design for recipient countries including Malawi. This means, therefore, that the scope for independent policy design (domestic policy making) and implementation in these countries has been virtually eliminated, as donors will only respond to the guidance provided by the Fund. This has created dependence on the Fund by recipient countries including Malawi.

Against this background, prolonged disengagement with the Fund is not a viable option for Malawi. Donors will not provide financial support to this country outside a framework of a formal Fund-supported programme. The consequences of the absence of such a framework is obvious, that is, unsustainable fiscal deficits, high interest rates, high inflation, and economic stagnation. The Authorities feel that this paragraph raises a lot of issues that can be misunderstood. With respect to programmes selectivity, Malawi is not worse off than a number of countries before Fund programmes improved their performance. Through the implementation of Fund supported programmes, such countries as Benin, Ghana, Tanzania, and Uganda, have had their economic programmes transformed through their implementation of Fund supported programmes.

8. **Further programme engagement by the Fund, if any, should be carefully phased to allow the authorities to build a track record while not over-burdening implementation capacity (Paragraph 63).** The need for a Fund-supported programme in Malawi cannot be over emphasized. In the same vein, a long Staff-Monitored Programme (SMP) of one year is tantamount to disengagement since for that period no donor funds will be disbursed. Thus, Government strongly believes that the Gatekeeper role (signaling) of the IMF makes it difficult for Government to consider a long-term disengagement as doing so would leave the country without donor assistance, the very essence of a Fund programme.

9. **Therefore, in the view of the ex-post assessment team, prior to any formal programme engagement, a credible and convincing track record of sustained policy**

implementation under a SMP is required, including sufficient time to test commitment and to verify compliance with targets, without being unduly protracted (Paragraph 63). No time frame is suggested for the staff monitored programme in this paper. As alluded to above, a year would be too long, as this country needs donor resources in order to establish a credible track record. This is because future disbursements by our development partners are dependent on engagement with the IMF. In the circumstances, it is doubtful whether a desirable track record could be established over a 12-month period during which Malawi does not receive budget support. A SMP of 4-6 months would be more realistic.

CONCLUSION

The Malawi economy is still fragile and vulnerable to shocks. In this regard, programme disengagement or a longer SMP will have a destabilizing effect on the economy. The Government, therefore, strongly believes that this is not a viable option. Moreover, the signaling role that the IMF has assumed makes it imperative to have a programme.

/s/
Goodall E. Gondwe
Minister of Finance

Malawi: Relations with the Fund
(As of August 31, 2004)

I. **Membership Status**: Joined 07/19/1965; Article VIII (December 7, 1995)

II. **General Resources Account**:	SDR million	percent Quota
Quota	69.40	100.0
Fund holdings of currency	84.46	121.7
Reserve position in Fund	2.29	3.3

III. **SDR Department**:	SDR million	percent Allocation
Net cumulative allocation	10.98	100.0
Holdings	0.32	2.94

IV. **Outstanding Purchases and Loans**:	SDR million	percentQuota
Poverty Reduction and Growth Facility (PRGF) arrangements	46.53	67.04
Emergency Assistance	17.35	25.0

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	12/21/2000	12/20/2004	45.11	12.88
ESAF/PRGF	10/18/1995	12/16/1999	50.96	50.96
Stand-by arrangement	11/16/1994	06/30/1995	15.00	12.73

VI. **Projected Obligations to Fund, Including Board-Approved HIPC Initiative Assistance**
(in millions of SDRs; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	3.95	12.36	17.86	13.41	5.37
Charges/Interest	0.30	0.94	0.74	0.43	0.28
Total	4.25	13.30	18.61	13.84	5.65

VII. **Implementation of HIPC Initiative:**

	Enhanced Framework
A. Commitment of HIPC assistance	
Decision point date	12/21/00
Assistance committed (NPV terms) [1]	
Total assistance (US$ million)	643.00
Of which: Fund assistance (SDR million)	23.14
Completion point date	Floating
B. Delivery of Fund assistance (SDR million)	
Amount disbursed	6.94
Interim assistance	6.94
Completion point [2]	0.00
Additional disbursement of interest income	0.00
Total disbursements	6.94

VIII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Reserve Bank of Malawi (RBM) is subject to a safeguards assessment with respect to the Poverty Reduction and Growth Facility arrangement that was approved on December 21, 2000 and is scheduled to expire on December 20, 2004. An offsite safeguards assessment of the RBM was completed in July 2001. A follow-up on-site safeguards assessment was conducted in May 2003. The latter concluded that the RBM had made progress in remedying vulnerabilities, and it proposed steps to further strengthen the RBM's operations and safeguards, particularly in the areas of external audits, financial reporting, and internal controls.

[1] NPV terms at the completion point under the original framework; and NPV terms at the decision point under the enhanced framework.

[2] Under the enhanced HIPC Initiative, the nominal amount of assistance disbursed will include an additional amount corresponding to interest on amounts committed but not disbursed during the interim period, calculated using the average return (during the interim period) on the investment of resources held by, or for the benefit of, the PRGF-HIPC Trust.

IX. **Exchange Arrangements**:

The exchange rate of the Malawi kwacha is market-determined. On September 30, 2004, the exchange rate was MK 108.95 = US$1.00.

X. **Article IV Consultation**:

Malawi is on the standard 12-month Article IV consultation cycle. The last Article IV consultation (Country Report No. 02/181) was concluded by the Executive Board on August 5, 2002.

XI. **Technical Assistance**:

Date	Duration	Dept.	Recipient	Purpose	Form
01/00	1 year	STA	National Statistical Office	Statistics	Advisor
06/00	1 year	FAD	Ministry of Finance	Revenue administration	Advisor
11/00	2 weeks	FAD	Ministry of Finance	Improving fiscal data and commitment control	Mission
9/01	1½ weeks	FAD	Ministry of Finance	Expenditure tracking and fiscal ROSC	Mission
11/01	2 weeks	MAE	RBM	Monetary operations and further developing financial markets	Mission
02/02	2 weeks	FAD	Ministry of Finance	Expenditure policy	Mission
05/02	6 months	FAD	Ministry of Finance	Expenditure management	Advisor
07/02	2 weeks	STA	National Statistical Office (NSO), RBM	GDDS Anglophone project on national accounts statistics	Mission
08/02	2 weeks	STA	RBM	Monetary and financial statistics	Mission
02/03	2 weeks	MAE	RBM	Monetary operations, payments system, banking supervision	Mission
08/03	2 weeks	STA	NSO	GDDS Anglophone project on balance of payments statistics	Mission
09/03	2 weeks	STA	NSO, Ministry of Finance, RBM	ROSC on the quality of macroeconomic data	Mission
02/04	2 weeks	MFD	RBM	Monetary operations, credit quality assessment, payments system, banking supervision	Mission
04/04	2 weeks	STA	RBM	Monetary and financial statistics	Mission

XII. **Resident Representative**:

Mr. Thomas Baunsgaard since August 16, 2004.

Malawi: Relations with the World Bank Group

Contact person: Ms. Yisgedullish Amde, Tel. 202 473 2203

A. World Bank Country Assistance Strategy (CAS)

2. The Malawi CAS was approved by the Bank's board on May 14, 2003. The gray cover report (Report # 25906 MAI) outlined the current social, economic, and political situation in Malawi and proposed strategies for the next three years (FY04-06), based on the lessons learned from the previous strategies. This strategy presents a transitional program that aims to help the Government to address the urgent development issues as it is clear that business-as-usual strategy will not achieve the required results.

3. The program is organized under three pillars: i) strengthening economic management, ii) establishing a platform for growth; and iii) improving service delivery and strengthening the safety net. Three ongoing projects (Financial Management Transparency and Accountability; Privatization and Utility Reform; and Global Development and Learning Network), and a Structural Adjustment Credit (Fiscal Management and Accelerating Growth Project) will assist in attaining the objectives under pillar one. To support the objectives of pillar two, the on-going Community Based Land Reform Project, and two pipeline projects (Infrastructure Services Project, and Agriculture Project) are under the base case. Finally, core Bank interventions under pillar three include the HIV/AIDS (MAP) project; Third Malawi Social Action Fund Project; Secondary Education Project, and the Emergency Drought Relief Project, in addition to two sectoral projects under preparation in the area of education and health even in a low case.

B. Financial Relations with the World Bank Group

4. The World Bank has been active in Malawi since 1966. The World Bank Executive Board has since approved 94 IDA credits, 4 IDA grants, and 10 IBRD loans. Total lending to Malawi from the World Bank as of August 2004 is US$2,389.6 million, of which US$2,086.0 million has been disbursed. Currently there are twelve active projects in Malawi with a net commitment of US$381.6 million, and an undisbursed balance of US$262 million (as of August 29, 2004). Sectoral breakdown is as follows: Rural at 21 percent, Transport at 8 percent, Public and Private Sector Development and Finance at 33 percent, and Social Sectors at 39 percent.

5. IFC has five investments in Malawi, in capital markets, agribusiness, health, timber, and tourism, totaling a meager US$2.02 million (US$0.85 million in loans and US$1.16 million in equity). To address the issue of poor access to finance for SMEs, APDF in association with a regional organization, COMESA Bankers Association, has provided training for local bankers from Malawi as well as from other SADDCC countries. Future focus will be on expanded IFC assistance for the private sector, especially in areas of

manufacturing, mining and tourism that Malawi has indicated as its target areas to reduce its dependence on agriculture.

C. Areas in Which the Bank Leads

Education and health

6. The Multi-Sectoral AIDS Project (US$35 million in grants) was approved in FY04. The project will support efforts by the Government of Malawi to reduce HIV transmission and mitigate the impact of the disease throughout Malawian society, thus also fighting the poverty that AIDS brings to families and societies. A major study of Malawi's HIV/AIDS problem revealed 10 important constraints that the project, beginning in 2004 and running through 2008, will address through a range of activities, from capacity building in public, private, and civil society organizations to educational work for prevention, and increased support for AIDS orphans. Many of Malawi's other development partners are also active in this effort, pooling their funds to support this critical effort.

7. In addition, a Health Sector Project, and Education Sector Support Project are under preparation to be presented to the Board in FY05. A Secondary Education project (US$48 million) which was approved in FY98, is slated to close in December 2004.

Social protection and community development

8. MASAF is a long-term, wide-ranging poverty-reduction project that supports decentralization and community capacity building. The project aims to empower individuals, households, communities, and their development partners in the implementation of measures, which can assist them in, better managing risks associated with health, education, sanitation, water, transportation, energy and food insecurity, and to provide support to the critically vulnerable through a variety of sustainable interventions. The current Project, MASAF III (US$60 million, of which US$27 million is in the form of an IDA grant) was approved in FY03. The project encourages communities to develop social safety nets for their most vulnerable members (such as skills training for AIDS orphans), facilitates delivery of the most needed social services, and stimulates communities to save and invest.

Infrastructure

9. The Road Maintenance Project (US$30 million) was approved in FY99 to bring about sustainable improvements in the quality of Malawi's road infrastructure which will help economic growth and diversify the economy by reducing transport costs and improving access by: (a) strengthening and restructuring of the road sector institutional framework; (b) reform of road sector; and (c) addressing the backlog of road maintenance and rehabilitation. In the pipeline (FY05), is also an Integrated Infrastructure Services Project to primarily support rural energy, and transport needs.

Privatization

10. Parastatal reform continues to be an urgent need in Malawi. In the past two years, progress has been made in several privatizations with Bank assistance through the Privatization and Utility Reform Project (PURP, US$28.9 million, approved in FY00). The PURP aims to improve quality of and access to economic and physical infrastructure, notably telecommunications, water, and power sectors, by promoting greater private-sector involvement. The Government's Privatization Commission identified some 100 public enterprises that should be privatized; the project aims to support the Commission's divestiture work through technical assistance and support for strengthening existing public enterprises, such as the postal service.

Agriculture

11. A Community based Rural Land Development Project (US$27 million) was approved by the Board in April 2004. Based on positive community-level experience gained in the MASAF projects, and in partnership with the Government and UK's Development agency, DFID, this project will involve the acquisition of idle land and their transfer to small farmers, thus enabling them to be self-sufficient in food and, hopefully, grow surpluses for commercial sale. It is urgent that Malawi move toward a more equitable distribution of land that will provide food security for smallholders. The new Structural Adjustment Credit, FIMAG, also supports agricultural policy reforms (see further details in paragraph 19 below).

12. An Irrigation, Rural Livelihoods and Agriculture project is under preparation at present (for FY06), to complement other activities on the ground. The main objective of the project is to support the implementation of the GoM National Irrigation Development Policy and Strategy; to support the implementation of the Government's new Extension Strategy; and to improve market access and efficiency of smallholders.

Environment

13. Direct Bank involvement in the environment sector is currently limited to the Mulanje Mountain Biodiversity Conservation Project (US$7 million), which was approved in FY01. The Project aims to raise awareness of the need for conservation, strengthen the capacity of the Forest Department and local communities to carry out conservation measures, and encourage more participation by local communities in managing the forest reserve. However, especially within the framework of MASAF, environmentally-sound community development initiatives are promoted and community resource management projects are funded.

Knowledge sharing

14. A Global Distance Learning Network Project (US$4 million) was approved in March 2004. Working in conjunction with the Malawi Institute of Management, the Bank Group plans to finance the creation of a Development Learning Center (DLC) that will provide

training in key fields to Malawian civil servants, including, for example, technical, policy development, and management

Poverty monitoring

15. The Bank is supporting the National Statistical Office with one aspect of the poverty monitoring tasks identified in the PRSP as requiring technical assistance. Through the PRSP Trust Fund, the Bank is assisting the government in conducting the Second Integrated Household Survey, including design, collection, processing, and dissemination of data covering not only household characteristics, but also community level indicators. A Poverty Assessment is planned for FY06, and provides an in-depth analysis of the new household data.

D. Areas Where the Bank and the Fund Share the Lead

Poverty reduction strategy

16. The Government of Malawi finalized its Poverty Reduction Strategy Paper (PRSP) in April 2002. A joint IDA-IMF staff assessment was presented to the Boards of IMF and the Bank on July 19, 2002 and the strategy was endorsed by the Boards of the IMF and the World Bank on August 5, 2002 and August 29, 2002, respectively. The IMF and the Bank staff maintained collaborative relationship in supporting the government in the process. The Malawi PRSP is considered by the Bank and the IMF as highly participatory (involving all stake holders), having an appropriate macroeconomic framework including a financing plan with a balanced approach to public policy, and having laid out detailed action plan. In October 2003, staffs of the World Bank and the IMF completed a Joint Staff Assessment (JSA) of the first Malawi PRSP Annual Review.

Debt sustainability and Enhanced Heavily Indebted Poor Country (HIPC) Initiative

17. Staff of the IMF and the Bank prepared "Malawi: Decision Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative" that was presented to the Board on December 8, 2000. The report recommended a reduction of US$331 million in Net Present Value (NPV) terms with respect to the debt owed by Malawi to IDA based on a proportional burden sharing approach accounting for 51 percent of total public debt, (69 percent of total multilateral debt). This is equivalent to 44 percent of outstanding World Bank group debt in NPV terms at the end of December 1999.

18. The staffs of the IMF and the Bank are currently working jointly on the update of the HIPC Activity Action Plan (AAP) report for Malawi.

Budgetary planning, revenues administration, and public expenditure reforms

19. Bank's assistance in improvement in public expenditure management has been channeled mainly via its most recent structural adjustment credit. The last adjustment operation, FRDP III, was approved in FY00 and is fully disbursed; it supported budgetary

reforms, liberalization of petroleum pricing and marketing, telecommunications and financial sectors, and creation of an affordable social safety net. The FRDP III also comprised a Technical Assistance parallel project, which closed in June 2004.

20. The Fiscal Management and Accelerating Growth (FIMAG, US$50 million) structural adjustment credit was approved by the Board, and the first tranche of US$25 million was released in September 2004. The FIMAG program focuses on four areas: (i) strengthening public expenditure management, (ii) privatizing state-owned enterprises, (iii) small-holder agriculture and land reform, and (iv) HIV/AIDS. All first tranche conditions (for Board presentation) have been met.

21. The Financial Management, Transparency and Accountability Project (FIMTAP, US$24 million, FY03) is also assisting the Government with improving financial management systems and increase their transparency. The main objectives are to build the capacity of Malawi's public servants in the areas of accounting, auditing, and other areas of managing public finance, and to introduce the use of the IFMIS computerized financial management system.

Civil service and wage reform

22. The World Bank has financed a study to review civil service and wage policy issues and propose a road map for reform. The Government has agreed to the road map, and has committed to begin implementation of the recommendations of the study in early 2004. These include: streamlining the system of allowances; consolidating them in the base for personal income tax; rationalizing salary grades; and moving towards a unified salary structure. These reforms are also supported under the proposed IMF program.

Humanitarian assistance

23. The Bank approved an Emergency Drought Recovery Credit (EDRC, US$50 million, of which US$21 million is in the form of an IDA grant) in FY03, with the following objectives: a) to allow government to maintain key commitments to economic priorities and investments; b) to help restore the productive capability of the populations; and, c) to support longer term disaster management by the government. The Board of the IMF also approved an Emergency Credit (US$23 million) to Malawi in September 2002, to support food imports.

E. Areas in Which the Fund Leads

Macroeconomic stability, fiscal policy, and monetary policy

24. Malawi is confronted with a number of macroeconomic challenges, including a history of repeated fiscal slippages and unpredictable monetary policies, a rapidly rising level of domestic debt, and a persistently high level of real interest rates. The Fund will work with the authorities to master these challenges, both through financial support and technical assistance, to make steady progress.

Malawi: Statistical Issues

1. Malawi's economic statistics show serious deficiencies, which have affected program monitoring. A draft Report on the Observance of Standards and Codes, November 2003, found that, while the legal and institutional framework for the production of macroeconomic statistics was broadly adequate, there are shortcomings in the scope, accuracy, and reliability of data. There is a need for strengthening the provisions of the Statistic Act to define the responsibility of the Ministry of Finance for the compilation of government finance statistics and of the Reserve Bank of Malawi in the compilation of monetary statistics. The authorities are making efforts to improve the quality and timeliness of the statistical data. Malawi is a participant in the GDDS and receives technical assistance under the project for Anglophone African countries that is sponsored by DFID.

F. Real Sector

2. Real sector statistics covering the national accounts, prices, and trade statistics need substantial improvements. Only a limited set of source data is available, and the quality and timeliness of the data need to be improved. Additional resources are needed by The National Statistics Office (NSO) to meet, in particular, the required quality standard of national accounts.

National accounts

3. The National Statistics Office has the responsibility for compiling the national accounts data. However, while the final estimates are comprehensive,[10] the source data underpinning these estimates are inadequate. There are gaps, especially for medium- and small-scale establishments, and informal activities that affect the coverage of the national accounts. The statistical techniques used for national accounts compilation are deficient, and processes to assess and validate source, intermediate and final data are generally limited. The national accounts are published in the *Statistical Yearbook* and *Quarterly Statistical Bulletin* with a significant time lag.

Prices

4. A consumer price index (CPI) is available on a timely basis. The CPI index is based on the 1997/98 household survey results, and data are collected on a monthly basis by regional price collectors. The effectiveness of the index could be improved by applying systematic, comprehensive, and consistent approaches to the quality adjustment of product prices. There is also a need to evaluate trends in the consumer prices against other relevant economic statistics, such as import and export prices, and commodity prices.

---

[10] Covering GDP from the production side at constant prices, GDP by expenditure at current prices, gross national income and its components, national disposable income and use of disposable income, and the capital finance account.

Trade

5. Preliminary estimates of trade are now available with a lag of two to three months. Trade data are received electronically from six major ports. The adjustment of imports from c.i.f. to f.o.b. prices is not appropriate and data reconciliation with bordering countries is lacking.

G. Government Finance

6. Malawi is not reporting government finance data for inclusion in the *Government Finance Statistics Yearbook (GFSY)* or in *International Financial Statistics (IFS).*

7. Malawi reports some fiscal data on a cash basis to AFR. Although administrative records are kept on a manual basis, the systems are designed to provide adequate information. However, there are serious quality problems, including data inconsistencies, that complicate program monitoring:

- While **tax revenue data** are received in a timely fashion, it is not always possible to reconcile them with deposits made into the MG Account No. 1.

- **Nontax revenue** collected by line ministries is not properly accounted for in the fiscal reports prepared by the Ministry of Finance. It also includes capital revenue.

- Data on **recurrent expenditure** suffer from serious shortcomings partly related to insufficient bank reconciliation at the level of line ministries (between spending records and financing information). The fiscal reports prepared by the Ministry of Finance show spending based on funding data (from the Credit Ceiling Authority). Line ministries subsequently submit spending reports to the Ministry of Finance based on recorded expenditure. There are at times sizable discrepancies between these two sources of data for both wages and other recurrent transactions—to some extent reflecting the widespread practice of reallocation across budget lines.

- Expenditure on domestically-financed **development expenditure** is based on funding released to line ministries, and data on externally funded expenditure is based on reported project grants and loans. Owing to differences in timing and financing modalities (e.g., some donors require prefinancing of expenditure before reimbursement), there are substantial differences between the flow of expenditure and corresponding financing data. Thus, there are substantial errors in the reporting of expenditure. Also, many donor projects are still not incorporated in the budget, and hence the corresponding expenditure is not at all captured in reports. Some externally funded development expenditures likely are of recurrent nature, and thus the reporting of capital expenditure is erroneous.

- Data on **expenditure arrears** are likely incomplete, as reporting from the Commitment Control System appears to be only partial, and ministry level data are not consistent from report to report. Previously unknown arrears have repeatedly been cleared through the "special activities" vote, thus calling into question the accuracy of arrears data as well as these data on clearances. [A recent audit of domestic arrears in [8] ministries and agencies has uncovered sizable arrears that were not previously reported.]

- The **budget classification and chart of accounts** may be adequate for some administrative, economic, functional and program classifications. An output-oriented activities-based budget classification (ABB) is used for the presentation of the budget. However, **pro-poor expenditures** that are protected in line with the PRSP are only identified in the ABB classification. As no bridge table exists that maps the ABB classification into the program classification used for expenditure reporting and accounting, pro-poor expenditures cannot be monitored.

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

25. 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 not been adequate. The new government has pledged to strengthen public financial management and fiscal reporting, and renewed efforts are being made to establish a work plan, including effectively utilizing donor technical assistance.

H. Monetary Accounts

26. The Reserve Bank of Malawi (RBM) reports monetary and financial statistics (MFS) to STA on a regular basis. The MFS reported are generally in line with the Fund's data needs. The MFS mission that took place in April - May 2004 noted that significant progress was achieved in implementing the recommendations made by the MFS mission conducted in August - September 2002. One of most notable achievements was the improved coverage of monthly monetary survey that now accounts for more than 90 percent of the banking sector. On the other hand, the mission also noted that some important recommendation were yet to be implemented. The mission recommended that improvements be implemented in several areas, such as the institutional coverage of the financial corporations, sectorization of the domestic economy, and classification of financial instruments to ensure that the MFS of the RBM adhere fully to the methodology of the *Monetary and Financial Statistics Manual*.

27. Concurrently, the mission completed the development of an integrated database that will be used by the RBM, STA, and AFR for publication and operational needs. The mission also discussed the standardized forms (SRF) that will be adopted in the near future by all

countries for reporting monetary data to STA. The RBM is examining the SRF with a view to reporting monetary data to the IMF using the SRF as soon as feasible.

I. Balance of Payments

28. Concepts and definitions used to compile the balance of payments statistics are in broad conformity with the guidelines presented in *BPM4*. Progress has been made in the transition to the methodology of *BPM5*. The NSO has provided these data to the IMF's Statistics Department for publication in the 2003 Balance of Payments Statistics Yearbook. Mainly as a result of the liberalization of exchange controls, the compilation of data relies on balance of payments surveys as the major available source of information for major components in the balance of payments, such as services, direct investment flows, and other financial transactions of the private sector. Data from primary sources (surveys and/or ITRS reports) are supplemented with information from secondary data sources, such as foreign trade statistics collected by the MRA through customs declarations, debt statistics from the MOF, and net foreign assets from the RBM. Organizational Measures

29. The NSO has expanded its Lilongwe office with a view to relocating some sections from Zomba.

30. Statistics produced by various units of the government have often differed and are difficult to reconcile. Some progress has, however, been made in generating more consistent data. For instance, the NSO and the National Economic Council (NEC) now harmonize their national accounts figures and, in fact, present a common set of figures. Similarly, the RBM and the Ministry of Finance and Planning now have meetings where government debt and related statistics are harmonized. These efforts need to be sustained and intensified.

Malawi: Core Statistical Indicators
(As of September 30, 2004)

	Exchange Rates	International Reserves	Reserve Money	Central Bank Balance Sheet	Broad Money	Treasury and RBM Bill Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt Service
Date of latest observation	03/04	03/04	07/04	07/04	07/04	07/04	01/04	10/03	2000	04/04	2000	04/01
Date received	04/04	04/04	09/04	09/04	09/04	09/04	03/04	03/04	05/01	06/04	03/01	05/01
Frequency of data[1]	D	W	W	W	M	B	M	M	A	M	A	M
Frequency of reporting data[1]	D	W	W	W	M	W	M	Q	Q	M	A	Mission
Source of data[2]	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting[3]	M	M	M	M	C	M	C	C	C	C	C	Mission
Confidentiality[4]	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of publication[1]	M	M	M	Q	M	W	M	A	A	A	A	…

[1] D = daily; W = weekly; B = biweekly; M = monthly; Q = quarterly; and A = annual.
[2] A = direct report by the authorities; and N = official publication.
[3] C = cable or facsimile; and M = e-mail.
[4] C = unrestricted use.

Malawi: Selected Social and Demographic Indicators

	Malawi, Latest Single Year			Sub-Saharan Africa	Low-Income Countries
	1970-75	1980-85	1995-2003		
Population					
Total population (millions)	5.2	7.3	11.0	688.9	2,494.6
Growth rate (annual average for period)	3.0	3.2	2.2	2.5	1.9
Urban population (percent of population)	7.7	10.3	15.5	33.1	30.6
Total fertility rate (births per woman)	7.5	7.5	6.1	5.1	3.5
Poverty (percent of population) 1/					
National	...	...	65.3	...	...
Urban	...	...	54.9	...	...
Rural	...	...	66.5	...	...
Income 2/					
GNI per capita (*World Bank Atlas* method; U.S. dollars)	130	160	160	450	430
GNI per capita (PPP - current international dollars)	213	355	573		
Consumer price index (1995=100)	...	9.9	533.8	...	...
Food price index (1995=100)	...	8.4	477.5	...	...
Income/consumption distribution (share of income or consumption)					
Gini index	...	...	50.3	...	...
Lowest quintile (percent of income or consumption)	...	...	4.9	...	...
Highest quintile (percent of income or consumption)	...	...	56.1	...	...
Public expenditure					
Health (percent of GDP)	...	...	7.8	6.0	4.4
Education	2.5	3.3	4.1	3.4	2.5
Social security and welfare	...	...	...	...	...
Access to improved water source (percent of population)					
Total	...	...	57.0	58.2	76
Urban	...	...	95.0	82.8	90
Rural	...	...	44.0	46.5	70
Immunization rate (percent under 12 months)					
Measles	...	49.0	69.0	57.6	65
DPT	...	55.0	64.0	53.7	65
Child malnutrition (percent under 5 years)	...	29.9	25.4	...	...
Life expectancy at birth (years)					
Total	42.2	45.5	37.5	45.8	59
Male	41.5	44.8	37.1	46.6	58
Female	42.9	46.3	38.0	45.1	60
Mortality					
Infant (per 1,000 live births)	189.0	157.0	113.0	103.1	78.6
Under 5 (per 1,000 live births)	330.0	265.0	182.0	173.9	120.8
Adult (15-59)					
Male (per 1,000 population)	479.4	428.6	701.0	519.5	260.9
Female (per 1,000 population)	387.9	348.6	653.0	461.1	259.1
Births attended by skilled health staff (percent)	...	...	55.6	...	...

Source: World Bank, *World Development Indicators* , 2004 and http://www.developmentgoals.org.

1/ These data are for 1998.
2/ Gross national income (GNI) data for Malawi are from 1975, 1985, and 2002; income data for sub-Saharan Africa and low-income countries are for 2002.

MALAWI: HIPC COMPLETION POINT TRIGGERS UPDATE – September 2004[11]

Malawi reached the decision point in December 2000. The total amount of debt relief assistance to Malawi is equivalent to around US$1.0 billion in nominal terms (US$643 million in NPV terms). Debt relief will be delivered between January 2001 and December 2020 by providing 55 percent relief on annual debt service due.

IDA is the largest creditor to Malawi, accounting for 51 percent of the entire external debt (and 69 percent of multilateral debt). IDA approved debt relief for US$588 million in nominal terms (US$331 million in NPV terms), equivalent to US$29 million of debt relief on average per year.

The debt relief will become irrevocable only after Malawi reaches the completion point. Prior to that time, Malawi is receiving interim relief, which cannot exceed one third of the total assistance to be provided by IDA (in NPV terms).

The completion point could be reached in late 2005 if Malawi achieves:

(i) **Satisfactory macroeconomic performance (as demonstrated by a minimum six-month track record under a new PRGF)**.

(ii) **One-year satisfactory MPRSP implementation:** The full MPRSP was completed in April 2002 (and endorsed by the Boards in August 2002). The first Annual Progress Report approved by the Boards in October 2003 indicates that MPRSP implementation has been limited. The second APR is expected in the Fall 2004. Thus satisfactory one-year implementation of PRSP could be met at the earliest in Fall 2004.

Satisfactory implementation of the outstanding completion point triggers:
(Note: substantial progress has been achieved – see next page for triggers already met)

[11] Source: World Bank

Completion point triggers not met:

Specific triggers still outstanding	Status and actions to accelerate
Safety nets: • A rationalization and prioritization of existing and new programs, under the National Safety Net Strategy. • Establishment of a monitoring and evaluation of the National Safety Net Strategy	• Partially met. Concept paper approved by cabinet in February 2002. Safety nets unit has been created but not yet coordinating safety nets policy. Inception phase with DFID assistance ongoing, but limited progress so far. • Partially met. Monitoring and evaluation of some individual projects is carried out, but evaluation of overall policy has not started.
Health • Completion of 'phase one' reforms of the Central Medical Stores (CMS).	• Not met. Work on this issue has proceeded slowly. Reforms being discussed in context of Health SWAP.
Education • Reallocate budgetary resources from secondary school boarding (except for 'special needs' education) to teaching and learning materials.	• Partially met. Some secondary schools are still operating as boarding.
Land Policy • Submission of draft Land Law to parliament.	• Not met. Land policy adopted by cabinet in January 2003; submission of Land Law to parliament expected in 2004.
Microfinance • Establishment of a monitoring system covering all microfinance institutions.	• Not met. (Government feels this is not their role—need to follow up)

Completion point triggers already met:

Area and specific triggers	Status and actions to accelerate
Public expenditure • Quarterly expenditure reporting as per format jointly developed by MOF/IDA. • Implement IFMIS in four pilot ministries.	• Met. Format agreed. Pro-poor expenditures are published on the government web site. • Met. IFMIS will be rolled out to all ministries as part of the FIMTAP project.
Microfinance • Approval by Cabinet of the 'Microfinance Policy'. • Increase number of microfinance clients by 20 percent.	• Met. Policy approved at end-October 2002. • Probably met. (Difficult to verify.)
Governance • Separation of fiscal management and audit functions under new legislation.	• Met. New Audit Act and Financial Management Act have been approved by parliament in May 2003. The Procurement Act has also been passed in May 2003
Safety nets Transform universal starter-pack distribution into a Targeted Input Program (TIP) for 2001/02.	• Met in 2001/02. Decision to revert to almost universal TIP (mainly donor funded) in 2002/03 and 2003/04 as result of food crisis. Voucher-based TIP and subsidy planned in 2004/05 for 60 percent of households.
Health • A share of health expenditure of at least 13 percent of discretionary recurrent budget. • Recruitment, training and deployment of at least 200 hundred nurse technicians, 50 new medical assistants and 20 radiography technicians per annum. • Budget for drugs and medical supplies in line with BHA standard (US$1.25 per capita).	• Met. Respectively, 15.2 percent for 2001/02 (revised budget) and 18.4 percent for 2002/03 (budget). • Met. Currently training over 500 nurses technicians; 130 medical assistants and 20 radiography technicians, respectively. • Met. Drugs budget at $1.44 and $1.23 in 2001/02 and 2002/03 respectively, broadly in line with BHA standard.
HIV/AIDS: Implementation of National Aids Strategy. • Fully staffed, functional and autonomous National AIDS Control Secretariat.	• Met. National AIDS Secretariat has been operational since end-2001. Need for additional staffing to enhance NAC' coordination effectiveness.

• 75 percent of all condom outlet points with condoms in stock at any given time. • Continuous availability of testing kits at all blood transfusion sites by increasing blood testing kits from 1500 to 2500. • Implementation of an effective Behavior Change Communication Strategy. • Syndromic Management of sexually transmitted infections (STI) in all Central, District and major CHAM hospitals.	• Met. 80 percent availability in grocery shops, and 65 percent availability in public hospitals. (Difficult to verify.) • Met. More than 3000 testing kits have been supplied by end-2003. • Met. Implementation of communication strategy has started. • Met.
Education • Share of education sector[12] expenditure in discretionary recurrent budget of at least 23 percent. • Yearly enrollment of 6000 students for teacher training and institution of in-service training for primary teachers (at least once each year). • Pre-packaging of donor-supplied primary textbooks for each school and direct supply from the supplier to the schools.	• Met. Respectively, 29.1 percent for 2001/02 (revised budget) and 29.1 percent for 2002/03 (budget). • Met (need to verify). Only about 2850 teachers graduated in 2001/02 and 3150 teachers in 2002/03. Double cohort system planned in January 2004, would bring total number of students to over 6000. • Met. Donor-supplied textbooks are pre-packed and directly supplied.

[12] Ministry of Education, Universities, MANEB, MIE, scholarship fund and Polytechnic Board of Governors.

Malawi: External Debt Sustainability Analysis

The objective of this appendix is to assess Malawi's external debt dynamics in the medium term. This analysis (DSA) is based on the new proposed framework for external debt sustainability in low income countries[13].

Malawi's stock of external debt at end-1999 was estimated at US$2,608 millions in nominal terms, equivalent to 144 percent of GDP. At end-2003, the debt has reached 166 percent of GDP, in line with the expectations of new borrowing at the time of the HIPC decision point. Malawi's largest creditors continue to be multilateral institutions and Japan.

The main assumptions underlying the baseline scenario are:

- A recovery in the real GDP growth in the immediate future, rising to 6 percent per year by 2010 and stabilizing at 5.5 percent thereafter.

- Export volumes are expected to grow at a rate of about 3.5 percent over 2005-10 and 4 percent from there onward. Tobacco will continue to be the main export product (about 60 percent of total exports), but this share will be slowly reduced to 50 percent by 2023 as a result of lower export volume growth and smaller price increases (about 2 percent per year). The projections envisage some effort to promote non-traditional exports. Import volumes are projected to grow at a rate of about 3.5 percent per year.

- Foreign direct investment is envisaged to average US$35 million during 2005-10 and increase to US$55 million during 2011-20.

- Official grants are expected to remain at about US$90 million during 2005-10 and to jump to about US$125 million during 2011-20. The residual financing gaps will be covered by concessional loans, resulting in high new borrowing. In this connection, loan disbursements will have to increase from an average of about US$120 million during 1999-2004 to US$200 million during 2005-09 and to US$260 during the next decade.

- Malawi is assumed to reach the HIPC completion point at end-2005.

[13] This framework differs from the one applied for HIPC countries, in particular regarding the discount rates and the use of current exports and not three-year average. A full DSA on a loan-by-loan basis will be carried out at the time of the HIPC completion point.

Results based on preliminary borrowing data show that:

- Under the baseline scenario, the nominal public debt relative to GDP peaks in 2003 at 166 percent of GDP and falls after reaching the HIPC completion point. By 2023 the nominal debt-to GDP would be less than half the level reached at end-2003. However, in terms of net present value (NPV) of debt-to-export ratio (current-year exports) shows that the external debt will continue to be a problem. The NPV of debt to exports will go down from 514 percent in 2003 to 325 percent in 2023 because of the high reliance on foreign loans.

- The alternative scenarios reveal that Malawi's external debt indicators are significantly sensitive to the level of concessionality of new borrowing and that if key macroeconomic variables remain at their historical averages, the NPV of debt-to-exports will go back to the levels experienced in 2003, even after reaching the completion point.

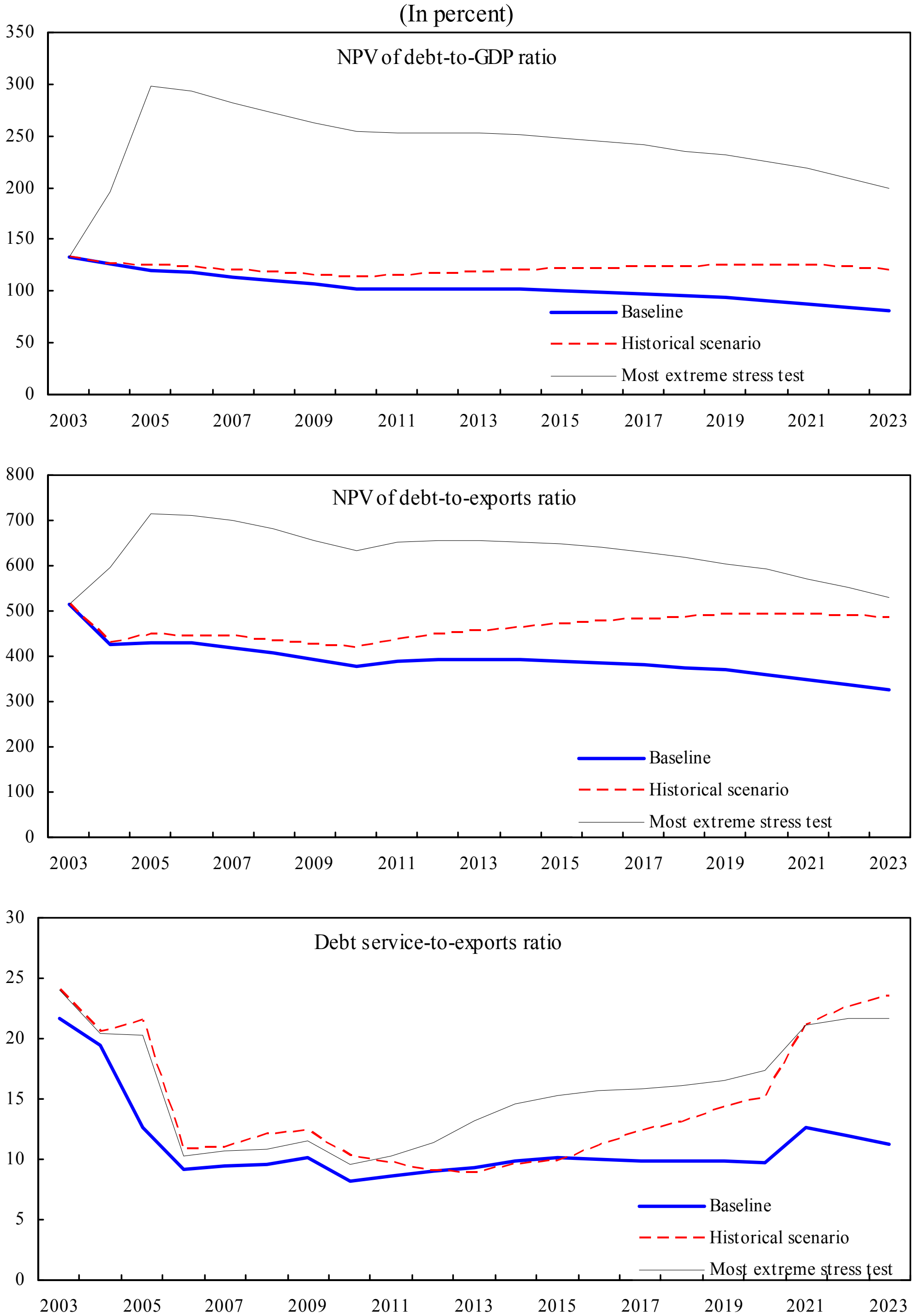
- The bound tests reveal that an "export shock" (bound test B2) will result in a substantial increase in the NPV of debt-to-export ratio (from 429 percent to 714 percent) and in the debt service ratio (from 13 percent to 33 percent) in 2005.

Conclusions:

- The external debt sustainability remains a serious concern, even after reaching HIPC completion point. Unless the authorities make a serious effort to maintain effective macroeconomic policy implementation, the external debt indicators will significantly deteriorate. Sustaining faster growth policies would be key to Malawi's debt sustainability. Intensification of structural reforms to increase export is vital, in particular to reduce Malawi's dependence on tobacco exports.

- The alternative scenarios show that Malawi's government should follow a prudent borrowing strategy, borrowing under high concessional terms only and should increase its reliance on grants.

Figure 1. Country: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2003-2023
(In percent)



Source: Staff projections and simulations.

Table 1. Malawi: External Debt Sustainability Framework, Baseline Scenario, 2000-2023 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 5/	Standard Deviation 5/	Estimate	Projections								
	2000	2001	2002			2003	2004	2005	2006	2007	2008	2003-08 Average	2013	2023	2009-23 Average
External debt (nominal) 1/	**156.7**	**160.5**	**148.8**			**166.3**	**161.3**	**88.7**	**89.9**	**91.4**	**92.8**		**94.8**	**78.8**	
o/w public and publicly guaranteed (PPG)	156.7	160.5	148.8			166.3	161.3	88.7	89.9	91.4	92.8		94.8	78.8	
Change in external debt	12.6	3.8	-11.7			17.6	-5.1	-72.5	1.2	1.5	1.3		0.6	-2.1	
Identified net debt-creating flows	12.5	5.4	-3.8			35.3	20.2	14.6	9.3	7.4	6.6		3.3	0.0	
Non-interest current account deficit	**3.4**	**5.3**	**10.7**	**5.8**	**4.3**	**7.2**	**7.8**	**6.8**	**6.9**	**7.8**	**8.2**		**6.1**	**2.4**	4.8
Deficit in balance of goods and services	12.6	11.6	24.0			17.0	15.5	13.4	12.6	12.1	12.4		9.9	5.1	
Exports	26.9	28.7	25.4			25.9	29.6	28.0	27.7	27.1	27.0		25.9	24.9	
Imports	39.4	40.3	49.5			42.9	45.1	41.5	40.3	39.3	39.4		35.8	30.0	
Net current transfers (negative = inflow)	-9.1	-6.3	-13.4	-8.2	3.7	-9.8	-7.6	-6.6	-5.8	-4.3	-4.2		-3.8	-2.7	-3.6
Other current account flows (negative = net inflow)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Net FDI (negative = inflow)	**-1.6**	**-1.6**	**-2.0**	**-1.2**	**0.9**	**-2.5**	**-2.5**	**-1.6**	**-1.6**	**-1.7**	**-1.6**		**-1.5**	**-1.3**	-1.5
Endogenous debt dynamics 2/	**10.6**	**1.7**	**-12.5**			**30.6**	**14.8**	**9.4**	**4.1**	**1.2**	**0.0**		**-1.3**	**-1.1**	
Contribution from nominal interest rate	1.9	1.6	1.2			1.6	1.4	1.0	0.8	0.8	0.8		0.8	0.7	
Contribution from real GDP growth	37.7	32.9	6.0			29.0	13.4	8.4	3.3	0.4	-0.8		-2.1	-1.8	
Contribution from price and exchange rate changes	-29.0	-32.7	-19.7			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**0.1**	**-1.6**	**-7.8**			**-17.7**	**-25.3**	**-87.1**	**-8.1**	**-5.9**	**-5.2**		**-2.7**	**-2.1**	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt	...	...	114.5			133.1	126.7	120.3	118.4	114.0	110.1		102.1	80.8	
In percent of exports	...	...	450.1			514.4	427.5	428.8	427.8	420.1	407.2		393.6	324.6	
NPV of PPG external debt	**...**	**...**	**114.5**			**133.1**	**126.7**	**120.3**	**118.4**	**114.0**	**110.1**		**102.1**	**80.8**	
In percent of exports	...	...	450.1			514.4	427.5	428.8	427.8	420.1	407.2		393.6	324.6	
Debt service-to-exports ratio (in percent)	20.2	19.1	16.8			21.7	19.5	12.7	9.2	9.4	9.6		9.3	11.3	
PPG debt service-to-exports ratio (in percent)	20.2	19.1	16.8			21.7	19.5	12.7	9.2	9.4	9.6		9.3	11.3	
Total gross financing need (billions of U.S. dollars)	124.4	155.8	240.8			175.1	198.6	169.2	156.9	186.5	208.0		218.9	229.4	
Non-interest current account deficit that stabilizes debt ratio	-9.2	1.5	22.3			-10.3	12.9	79.3	5.7	6.3	6.8		5.5	4.5	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-24.7	-20.9	-4.1	-21.7	19.2	-17.8	-8.5	-5.6	-3.9	-0.5	0.9	-5.9	2.4	2.4	2.2
GDP deflator in US dollar terms (change in percent)	25.2	26.3	14.0	33.3	20.2	11.1	14.6	14.2	8.9	6.7	5.7	10.2	4.0	4.0	4.2
Effective interest rate (percent) 4/	1.3	1.0	0.8	1.4	0.4	1.0	0.9	0.6	0.9	0.9	0.9	0.9	0.9	0.9	1.0
Growth of exports of G&S (US dollar terms, in percent)	-9.5	6.9	-3.2	2.1	13.9	-7.1	20.1	2.0	3.3	4.2	6.2	4.8	6.2	5.7	6.0
Growth of imports of G&S (US dollar terms, in percent)	-14.7	2.2	34.1	3.7	21.2	-20.9	10.4	-0.9	1.8	3.4	7.1	0.1	4.6	4.7	4.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	40.4	54.4	44.7	86.8	105.2	84.2	69.3	56.0	55.1	59.7
Memorandym item:															
Nominal GDP (millions of US dollars)	1,707	1,705	1,864			1,702	1,786	1,925	2,015	2,139	2,280		3,134	5,896	

Source: Staff simulations.

1/ Public sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Current-year interest payments devided by previous period debt stock.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2. Malawi: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2003-23
(In percent)

	Estimate	Projections						
	2003	2004	2005	2006	2007	2008	**2013**	2023
NPV of debt-to-GDP ratio								
Baseline	133	127	120	118	114	110	**102**	81
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2004-23 1/	133	127	125	123	120	118	**118**	121
A2. New public sector loans on less favorable terms in 2004-23 2/	133	128	123	122	119	116	**115**	100
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	133	196	298	293	282	273	**253**	200
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	133	130	127	125	121	117	**108**	84
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	133	128	123	121	117	113	**105**	83
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	133	129	123	121	117	113	**105**	82
B5. Combination of B1-B4 using one-half standard deviation shocks	133	161	201	198	191	184	**171**	132
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	133	172	163	160	154	149	**138**	109
NPV of debt-to-exports ratio								
Baseline	514	428	429	428	420	407	**394**	325
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2004-23 1/	514	429	447	446	443	435	**456**	485
A2. New public sector loans on less favorable terms in 2004-23 2/	514	433	439	443	439	430	**445**	403
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	514	428	429	428	420	407	**394**	325
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	514	596	714	713	701	680	**656**	529
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	514	428	429	428	420	407	**394**	325
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	514	434	439	439	431	418	**404**	329
B5. Combination of B1-B4 using one-half standard deviation shocks	514	554	614	613	602	584	**564**	455
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	514	428	429	428	420	407	**394**	325
Debt service ratio								
Baseline	22	19	13	9	9	10	**9**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2004-23 1/	24	21	21	11	11	12	**9**	24
A2. New public sector loans on less favorable terms in 2004-23 2/	24	20	20	10	11	11	**13**	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	24	20	21	10	10	11	**7**	16
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	24	28	33	17	17	18	**12**	27
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	24	20	21	10	10	11	**7**	16
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	24	20	21	10	10	11	**8**	17
B5. Combination of B1-B4 using one-half standard deviation shocks	24	26	28	14	14	15	**10**	23
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	24	20	21	10	10	11	**7**	16
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	62	62	62	62	62	62	**62**	62

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 04/132
FOR IMMEDIATE RELEASE
November 24, 2004

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2004 Article IV Consultation with Malawi and Discusses Ex Post Assessment of Performance Under Fund-Supported Programs

On October 29, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Malawi.[1]

Background

Malawi benefited from a modest economic recovery in 2002 and 2003. Overall inflation decreased sharply from 40 percent in 2000 to less than 10 percent in 2003. However, higher-than-programmed budget deficits have led to a doubling of domestic debt since June 2002.

Real GDP grew by an annual average of 3 percent in 2002–03. Agricultural production rebounded from the drought in 2001, but the 2004 harvest was affected by a drought and President wa Mutharika has appealed for humanitarian assistance to alleviate the crisis. Macroeconomic imbalances, high interest rates, and infrastructure constraints have adversely affected the non-agricultural economy. Manufacturing—mainly agro-processing activities—and distribution (together one-third of GDP) stagnated in 2002–03 and industrial activity remains at a very low level.

Fiscal policy slippages over much of the 2002–04 period have resulted in a unsustainable domestic debt situation and a high level of public expenditures. Largely unbudgeted expenditure for maize imports of 3.9 percent of GDP were a major factor in 2002/03, while 2003/04 was impacted by above budget spending in a number of non-pro-poor expenditure areas.

---

[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. 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.

Compounded by shortfalls in external financing and high interest rates, this led to a large increase in domestic borrowing.

Malawi's external current account deficit (excluding grants) mirrored changes in the government balance and the emergency maize imports in 2002. The 2002 current account deficit of 25 percent of GDP—about one-half of which was related to maize imports—was financed through a drawdown in official reserves and external assistance. The real effective exchange rate depreciated in 2002/03 as changes in the nominal exchange rate outpaced inflation, while the nominal kwacha-U.S. dollar exchange rate has remained stable after a 20 percent depreciation in August 2003.

Progress in implementing structural reforms was mixed. Several parastatal corporations were privatized and reforms have been implemented in the telecommunication, electricity, and water sectors. ADMARC's monopoly in the marketing of maize has been abolished and some businesses sold off. Plans for the commercialization of some the remaining ADMARC operations are under way. The Anti-Corruption Bureau (ACB) has been strengthened through an amendment to the Corrupt Practices Act that would increase transparency. The new administration has declared a policy of zero tolerance on corruption and has already taken steps to enforce this policy.

The Reserve Bank of Malawi has maintained high nominal interest rates. However, owing to higher-than-programmed government spending, pressures on nonfood inflation reemerged in the first half of 2004.

Malawi's performance under the Poverty Reduction and Growth Facility (PRGF) arrangement, approved in December 2000, was disappointing. The authorities requested Fund staff to monitor their economic program to establish a track record that could lead to a new PRGF arrangement.

The 2004/05 budget limits the domestic borrowing to 2 percent of GDP, down from 12 percent in 2002/03 and 8 percent in 2003/04. The budget aims at reducing expenditures across government while accommodating priority spending in areas such as food security and wage reform. Monetary policy will aim to achieve 10 percent inflation by the end of 2005 and structural reforms will focus on financial management. Key risks are budget implementation and inflation.

As part of the Article IV consultation, an assessment of the IMF's Longer-Term Program Engagement in Malawi was prepared by the staff and discussed with the authorities.[2] The assessment concludes that under the last two arrangements covering 1995–2003, performance has generally fallen short of expectations because of a lack of ownership, weak planning, insufficient monitoring, and lax enforcement of regulations. Furthermore, external resources have not always been put to good use because of limited implementation capacity and governance issues. The assessment also concludes that the periods of fastest growth in Malawi had coincided with implementation of relatively prudent fiscal and monetary policies.

[2] Such assessments are required for members with longer-term program engagement. Malawi has had arrangements with the IMF almost continuously since 1979.

Executive Board Assessment

Directors noted that economic growth picked up in 2003–04, inflation has been brought down, and the exchange rate has been stable for more than one year. Directors commended the new government's ownership of economic policies and recent actions to address corruption at the highest levels.

Directors noted, however, that although Malawi has recently recovered from a severe drought and food emergency, it now finds itself in a precarious macroeconomic and social situation. Above budget spending and delays in donor assistance over much of the past two years have left Malawi with an unsustainable level of domestic debt, high interest rates, and low private sector investment. In addition, widespread poverty and the high incidence of HIV/AIDS continue to present vast challenges.

Directors welcomed the determination to act decisively in meeting budget objectives. Adherence to the fiscal objectives in the Staff-Monitored Program—which will require effective expenditure controls—is critical for restoring macroeconomic stability, and the recent passage of the 2004/05 budget was a key step in this direction. Directors urged the authorities to quantify savings stemming from the ongoing government restructuring, including the reduction in the number of ministries and the relocation of the president's office to Lilongwe.

Directors generally agreed that the budget for 2004/05 balances the critical objective of restoring sound macroeconomic policies with pressing social needs. In this context, they considered the government's target of restricted domestic borrowing as appropriate. Directors emphasized that determined implementation of the budget will be essential. They welcomed the Ministry of Finance's refusal of requests for resources above the budget and stressed that ministries should find savings and set priorities in order to operate within their budgets. Based on preliminary information, Directors noted that performance had been good through end-September.

Despite recent encouraging inflation trends, Directors expressed concern over the recent pace of monetary expansion. They urged the Reserve Bank of Malawi (RBM) to mop up excess liquidity before it translated into higher inflation. They welcomed, therefore, the RBMs willingness to raise interest rates if necessary. Directors viewed Malawi's exchange rate policy as broadly appropriate. A few Directors took note of the differential with the exchange rate in the parallel market and the low level of reserves.

Directors further underscored the importance of food security in Malawi and expressed concern about the possibility of a maize shortage this year. They generally concurred with the government's plan to replenish the strategic grain reserve and welcomed the government's appeal to the international community for assistance to supplement its efforts. Directors welcomed the inclusion of these initiatives in the budget, although some expressed concern over the costs and scope for corruption of the subsidy programs for maize and fertilizer. They urged the authorities to solidify medium-term agricultural plans, including in the area of land reform.

Directors welcomed recent progress in implementing key structural reforms. The long planned civil service pay restructuring is about to be implemented, and ADMARC, the government-owned agricultural product marketing company, was about to adopt a new, more targeted role in providing public services. However, Directors encouraged further progress in public enterprise restructuring, and expressed concern that monopolies or oligopolies remain dominant in many sectors. They observed that progress in other areas, including the audit of domestic arrears and passage of legislation to strengthen financial management, would also contribute to a more efficient government. Directors welcomed the government's focus on anti-corruption, and urged strong enforcement.

Directors considered improvements in public expenditure management to be critical. These are needed to ensure that the government achieves its policy objectives—particularly those related to growth and poverty alleviation—within the available resource envelope. Directors welcomed the government's strengthened enforcement of budget procedures and plans to rebuild capacity in the budget process and expenditure control.

Directors noted that Malawi's economic program faces a number of risks. The steps now being taken by the government should help minimize the chances of near-term food shortages and enhance the prospects for macroeconomic stability. More will need to be done to lay a solid foundation for medium-term growth and sustainable poverty reduction. Directors, therefore, emphasized the importance of the evolving medium-term strategy and welcomed its emphasis on the private sector.

Directors agreed with the general conclusions reached by the Ex Post Assessment on the lessons from past Fund engagement and the guidelines for future Fund support. In particular, they noted that inadequate ownership and weak capacity were key factors behind the poor record of program implementation, and asked the staff, going forward, to take into account the concerns raised about program design and donor relations.

Directors were hopeful that the SMP will provide an opportunity for the authorities to demonstrate budget discipline and the ability to achieve targets under their economic program. Considering Malawi's need for balance of payments assistance, most Directors agreed that strong performance relative to the end-December targets in the SMP would be an important prerequisite for a new PRGF arrangement.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Malawi: Selected Economic and Financial Indicators, 2001-03

	2001 Act.	2002 Prel.	2003 Est.
(Percentage change, unless otherwise indicated)			
GDP and prices			
GDP at constant market prices	-4.1	1.9	4.4
Consumer prices (end of period)	22.1	7.6	9.8
Consumer prices (annual average)	27.2	14.9	9.6
GDP deflator	24.8	13.1	11.2
Interest rates (end of period) 1/	50.4	40.8	37.0
Nominal effective exchange rate (end period) 2/	39.3	-30.8	-18.0
Real effective exchange rate (end period) 2/	56.0	-35.3	-16.6
External sector			
Exports, f.o.b. (millions of U.S. dollars)	426.6	421.1	402.1
Imports, c.i.f. (millions of U.S. dollars)	584.5	726.8	629.6
Terms of trade	-0.3	-7.5	-7.9
Money and credit 3/			
Money and quasi money	21.2	25.2	29.3
Net foreign assets	-8.0	-55.4	21.5
Net domestic assets	29.2	80.6	7.8
Credit to the government	29.4	45.1	11.3
Credit to the rest of the economy	-2.9	4.1	8.1
(Percent of GDP, unless otherwise indicated)			
Central government 4/			
Revenue (excluding grants)	17.2	20.7	23.5
Expenditure	31.9	39.7	43.3
Underlying balance 5/	-2.8	-1.8	-0.9
Primary balance	-2.8	-5.0	3.7
Overall balance (cash basis, including grants)	-7.9	-12.1	-7.3
National saving	7.1	-1.0	2.4
Domestic saving	2.7	-12.0	-5.0
Net factor income	-1.9	-2.4	-2.4
Unrequited transfers	6.3	13.4	9.8
Net official transfers	5.7	12.6	9.0
Net private transfers	0.6	0.8	0.7
Gross investment	13.9	10.9	11.2
Public	10.4	8.0	9.7
Private	2.4	1.8	0.6
Stock building	1.1	1.0	0.9
External sector			
Exports, f.o.b.	25.0	22.6	23.6
Imports, c.i.f.	34.3	39.0	37.0
External current account (including official transfers)	-6.8	-11.9	-8.8
External debt	160.5	148.8	166.3

Malawi: Selected Economic and Financial Indicators, 2001-03

	2001 Act.	2002 Prel.	2003 Est.
Debt-service ratio 6/	20.0	20.3	23.5
Of which: interest payments 6/	6.3	6.2	6.6
(In millions of U.S. dollars, unless otherwise indicated)			
Usable gross official reserves 7/			
End-period stock	184.6	103.4	115.6
In months of imports of goods and nonfactor services 8/	2.7	1.7	1.8
External debt (disbursed and outstanding, end of period)	2,736	2,773	2,831
Memorandum items:			
GDP (in millions of kwacha)	123,080	142,928	165,751
Net domestic debt (in percent of GDP)			
Central government	7.4	18.1	23.2
Public sector 9/	10.7	15.4	19.9
Kwacha per U.S. dollar exchange rate (period average)	72.2	76.7	97.4
Per capita GDP (U.S. dollars)	162.0	173.5	155.3
Population (millions)	10.5	10.7	11.0

Sources: Malawian authorities; and Fund staff estimates and projections.
1/ Compounded three-month treasury bill interest rate.
2/ Positive value denotes appreciation of kwacha.
3/ Change in percent of money and quasi-money at the beginning of the period.
4/ Fiscal year starting July 1; information for 2001 refers to FY 2001/02, etc.
5/ This is a measure of domestic primary balance: overall balance plus statistical discrepancy, excluding grants, revenue from maize, total interest, expenditure for maize, and foreign-financed development expenditures.
6/ In percent of exports of goods and nonfactor services. Excludes debt relief.
7/ Excludes open letter of credit for 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.
8/ In percent of imports of goods and nonfactor services in the following period.
9/ Private sector holdings of central government debt and RBM bills.