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Republic of Madagascar: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Madagascar

In the context of the sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility with the Republic of Madagascar, the following documents have been released and are included in this package:

- the staff report for the sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on December 20, 2004, with the officials of the Republic of Madagascar on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 3, 2005. 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 Press Release summarizing the views of the Executive Board as expressed during its February 18, 2005 discussion of the staff report that completed the review.

- a statement by the Executive Director for the Republic of Madagascar.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Republic of Madagascar*

*May also be included in Staff Report

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.

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REPUBLIC OF MADAGASCAR

Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Departments)

Approved by Thomas Krueger and Mark Plant

February 3, 2005

- Discussions for the sixth and last review under the PRGF arrangement took place during December 6-20, 2004, in Antananarivo. The principal Malagasy representatives included Mr. Radavidson, Minister of Economy, Finance, and Budget, and Mr. Ravelojaona, Governor of the Central Bank of Madagascar (BCM). The mission was received by President Ravalomanana. The mission also met with other senior government officials, as well as representatives of the diplomatic community, churches, nongovernmental organizations (NGOs), and the business community.

- The staff team comprised Mr. Fayolle (head), Mr. Nassar, Ms. Allain (all AFR), Ms. Khemani (PDR), and Mr. Jahjah (Resident Representative). The mission worked closely with the World Bank staff based in Madagascar.

- The authorities have expressed interest in pursuing their relationship with the Fund in the context of a successor PRGF arrangement, after the current arrangement expires on March 1, 2005. A mission to discuss the Ex Post Assessment (EPA) is tentatively scheduled to take place together with the Article IV discussions in March 2005.

- The security environment in the capital, Antananarivo, gradually worsened over the past few months, with an increasing number of robberies and kidnappings targeting local businessmen, expatriates, and diplomats.

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Executive Summary

Recent developments and performance under the program in 2004

- Efforts to restore macroeconomic stability following the shocks that affected Madagascar during the first half of 2004 proved broadly successful, and growth is estimated to have reached 5.3 percent in 2004. However, inflation remains high and is one of the authorities' key concerns. Real exchange rate movements have been dominated by the sharp nominal depreciation of the currency, and the real exchange rate remained near its historical low in late 2004.

- Performance under the program was overall satisfactory, with all quantitative performance criteria at end-September, as well as the structural performance criterion and benchmarks at end-December, being met. However, the fiscal situation deteriorated in the fourth quarter, as current primary expenditure exceeded the program target by about 0.6 percent of GDP. The impact of these overruns on the domestic balance was mitigated by higher-than-anticipated revenue. The authorities have started to implement a set of corrective measures to prevent the recurrence of such slippages.

Economic policies for the period ahead

- The authorities remained committed to maintaining a tight policy stance in 2005, and understandings were reached on quarterly macroeconomic and fiscal targets designed to meet the inflation target of 5.5 percent (year-on-year) by December 2005.

- The substantial fiscal adjustment foreseen for 2005 will require vigorous implementation of the corrective actions to strengthen budgetary execution and control and additional revenue mobilization efforts. In particular, progress achieved in the area of customs reform in 2004 has to be consolidated.

- The authorities continue to work toward improving the effectiveness of monetary policy to ensure that monetary targets consistent with the inflation objective can be met. To this end, liquidity forecasting will be strengthened and cooperation between the central bank and the Ministry of Finance enhanced.

- Following the termination of the Multifibre Agreement in early 2005, the authorities will accelerate the implementation of structural reforms, with a view to improving the overall competitiveness of the economy and diversifying the export base.

- The authorities have expressed interest in pursuing their future relationship with the Fund in the context of a successor PRGF arrangement, after the current arrangement expires on March 1, 2005. A mission to discuss the Ex Post Assessment (EPA) is tentatively scheduled to take place together with the Article IV discussions in March 2005.

I. INTRODUCTION

1. On October 18, 2004, the Executive Board completed in principle the fifth review under the PRGF arrangement (IMF Country Report No. 04/404) and considered the Poverty Reduction Strategy Paper (PRSP) annual progress report (IMF Country Report No. 04/402, Vols. I and II) and the associated joint staff assessment (IMF Country Report No. 04/403). On October 22, 2004, Madagascar reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative, which will trigger the release of US$836 million in debt relief (in net present value (NPV) terms) over time. Upon the completion of the fifth review, Executive Directors commended the Malagasy authorities for their determined implementation of the PRGF-supported program in the face of deteriorating economic conditions, after two cyclones hit the island in early 2004. Directors stressed that the economic environment remained fragile and urged the authorities to remain focused on safeguarding macroeconomic stability. They also encouraged them to push ahead with reforms aimed at improving the business climate and diversifying the export base. Finally, Directors emphasized the need for Madagascar to continue a prudent borrowing policy and work toward stepping up capacity building.

2. Performance under the current arrangement has been broadly satisfactory, and this review would, for the first time, permit all disbursements to be completed under a PRGF arrangement with Madagascar.[1] Macroeconomic performance improved over the program period, except during the 2002 political crisis, with the economy growing at least 5 percent a year in real terms. The authorities also made significant progress in governance and improved the alignment of the budget with PRSP priorities. However, exchange and inflation rates remained volatile, and the current account deficit fluctuated substantially, underlying the economy's continued vulnerability to shocks and policy slippages. Performance on the fiscal front, in both revenue mobilization and public expenditure management, was uneven, and progress in implementing structural reforms often slower than envisaged.

3. In the attached letter of intent (LOI) dated February 3, 2005 (Appendix I), the Minister of Economy, Finance, and Budget and the Governor of the Central Bank of Madagascar (BCM) review economic and financial developments and implementation of structural reforms in 2004 and discuss economic perspectives and policies for 2005.

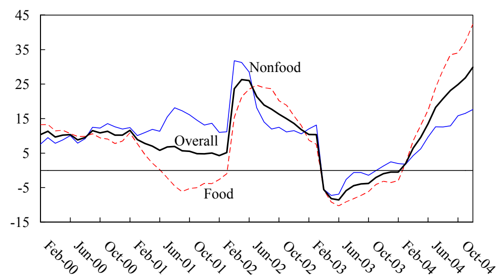
II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

4. **Efforts to restore macroeconomic stability following the shocks that affected Madagascar during the first half of 2004 proved broadly successful**. Although Madagascar was hit in early 2004 by two major cyclones, real GDP growth is still expected to reach 5.3 percent, spearheaded by strong performance in construction, export processing zones (EPZs), and tourism. However, inflation remains high, with the consumer price index

[1] These issues will be discussed in more detail in the upcoming Ex Post Assessment.

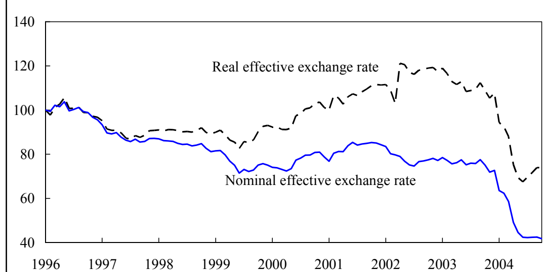
(CPI) increasing by 27 percent at end-December (on a year-on-year basis; Figure 1 and Text Table 1). This increase continues to be fueled by the rise in prices of petroleum products and rice, Madagascar's main staple food;[2] excluding these two goods, which constitute about 25 percent of the CPI basket, inflation has remained fairly stable over the last months. This surge in inflation led to an upward revision of nominal GDP growth to 20.3 percent for the year as a whole. With the rise in inflation, domestic price increases considerably exceeded those in partner countries in 2004. However, real exchange rate movements have been dominated by the sharp nominal depreciation of the currency, and the real exchange rate remained near its historical low in late 2004 (Figure 2).

Figure 1. Consumer Price Index, February 2000–December 2004 (Percentage change, year–on–year basis)



Source: Malagasy authorities.

Figure 2. Real and Nominal Exchange Rates, January 1996 – October 2004 (Monthly average, 1996=100)



Source: IMF: *International Financial Statistics* .

Text Table 1. Actual and Projected Inflation, 2004

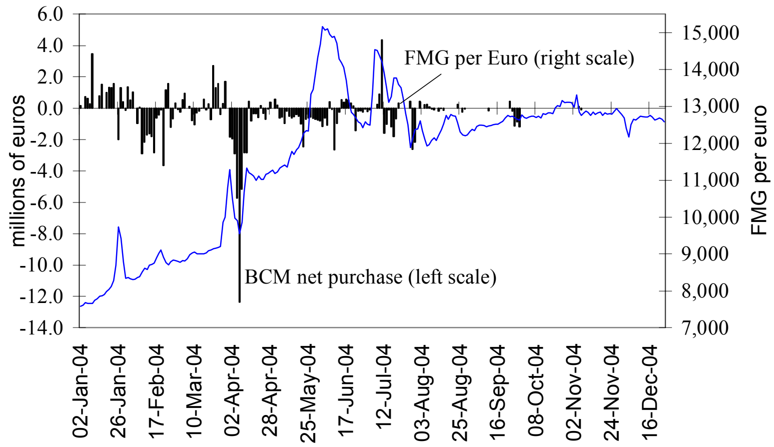
	Mar-04	Jun-04	Jul-04	Aug-04	Sep-04	Oct-04	Nov-04	Dec-04	
								Prog.	Act.
Monthly increase	2.3	2.3	3.2	1.8	2.2	1.8	2.8	...	2.0
12-month increase	2.0	13.3	17.8	19.9	22.1	24.0	26.0	14.9	27.0
Memorandum items (12-month basis):									
Contribution of rice prices to inflation	0.2	3.1	6.3	8.3	10.8	10.0	12.0	...	12.7
Contribution of oil prices to inflation	0.0	4.4	5.1	6.3	5.6	5.7	7.8	...	6.9
Contribution of other prices to inflation	1.7	5.8	6.4	5.4	5.8	8.2	6.1	...	7.4

Sources: Ministry of Economy, Finance, and Budget; and Fund staff projections.

[2] The rice imports from Asia, originally expected for end-September, have only partially arrived, and took place significantly later than had been envisaged (the bulk of the shipments arrived in December). In this context, the related price decrease, which had been anticipated to take place in the fourth quarter of 2004, has not materialized.

5. **All quantitative performance criteria at end-September, as well as the structural performance criterion and benchmarks at end-December, were met** (Appendix I, Attachments III and IV). Tax revenue was higher than programmed at end-September thanks to a good performance at customs. Successive monetary tightening measures have contributed to the stabilization of the exchange rate market since June 2004 (Figure 3), allowing for the performance criterion on the floor of net foreign assets to be met, and maintaining reserve money growth in line with the indicative target at end-September. However, the indicative targets on the ceiling on broad money growth and on the floor on arrears payments were missed. On the structural front, the resolution on the use of the new ASYCUDA ++ software at customs, a structural performance criterion at end-December, was issued on December 29, 2004, and the two BCM's benchmarks (publication of the audited financial statements for 2003 and issuance of the operational guidelines for central bank interventions in the interbank foreign exchange market) were also met.

Figure 3. Net Purchase of Foreign Exchange by the Central Bank, January 2 – December 30, 2004 (in euros)



Source: Central Bank of Madagascar (BCM)

6. **The fiscal situation deteriorated significantly in the fourth quarter, with current primary expenditure exceeding the program target by 0.6 percent of GDP**. In part, this stemmed from the underbudgeting of certain expenditures (notably military wages and civil service pensions), which became evident during the fourth quarter.[3] In addition, unanticipated payments were incurred, mainly on account of indemnities to civil servants in the Ministry of Finance and payments to the utility company Jirama. These overruns reflect, in part, a large recourse to the emergency spending procedure.[4] Staff reached understandings with the authorities on a list of corrective measures (see ¶18 below) aimed at preventing a recurrence of such slippages. However, total expenditure remained below program projections, due to lower-than-anticipated foreign-financed capital expenditure.

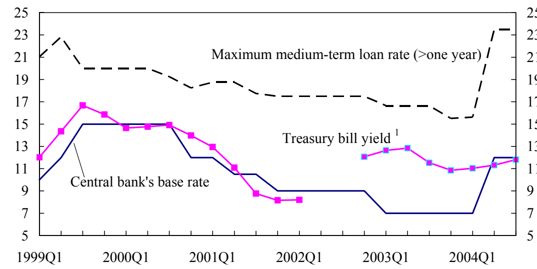
[3] This issue had already been flagged in the September 2004 memorandum of economic and financial policies (MEFP) and the staff report for the fifth review (IMF Country Report No. 04/404).

[4] The emergency spending procedure allows for expenditures to be paid directly by the Treasury even in the absence of a payment order, thus bypassing the usual procedure. Such expenditures are supposed to be regularized, at the latest, before the commitment period ends—that is, for 2004, before October 31.

7. **The impact of the expenditure slippages on the domestic balance should be mitigated by higher-than-anticipated revenue**. The overall revenue projection (excluding grants) for 2004 has been revised upward to account for higher-than-anticipated nontax revenue in the form of payments from the central bank,[5] and the nominal tax revenue target has been increased to reflect the expected good performance of customs revenue in the last quarter. However, this revision would only partially match the upward revision in nominal GDP, so that the tax revenue-to-GDP ratio is now projected to reach 11 percent of GDP in 2004, against 11.2 percent in the PRSP projections.[6] The revision of the nominal revenue target, combined with a small downward revision in interest payments and in domestically financed capital expenditure, should limit the impact of the expenditure overruns on the domestic balance to 0.2 percent of GDP.

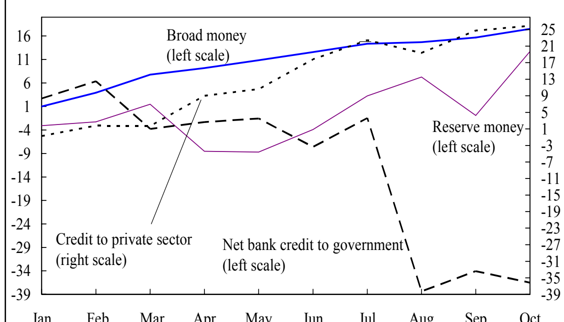
8. **In spite of the tightening of liquidity conditions, broad money growth exceeded the program target at end-September**. The BCM increased its base rate three times between April and September (from 7 to 16 percent), and increased reserve requirements on two occasions. Following these measures, the maximum medium-term lending rates increased from 15.5 percent at end-December 2003 to 23.5 percent at end-September 2004 (Figure 4) and weighted yields on treasury bills rose from 11 percent at end-June 2004 to 17.3 percent at end-December 2004 (see Figure 5 attached), keeping interest rates substantially higher than inflation (excluding rice and oil prices). However, the growth of broad money remained sustained, reflecting the higher-than-programmed accumulation of foreign exchange reserves and a robust increase in credit to the private sector during the second half of the year. This increase reached 26 percent at end-October, driven by the pickup in economic activity in several sectors (including tourism and construction), as well as a sharp increase in

Figure 4. Weighted-Average Interest Rates, 1999:Q1–2004:Q3
(In percent)



Source: Malagasy authorities.
[1] No treasury bill auctions were conducted during March-September 2002.

Figure 6. Money and Credit Developments, 2004
(Percentage change since end-December 2003)



Source: Malagasy authorities.

[5] The payments, amounting to 0.3 percent of GDP, were related to the revaluation of the BCM's net foreign assets in the wake of the large exchange rate depreciation. This amount was used to repay the Treasury's statutory advances from the central bank.

[6] The low revenue elasticity with respect to nominal GDP reflects the significant contribution of non-taxable sectors (EPZs and agriculture) to growth.

credit to privately owned oil companies following the liberalization of the sector in 2004 (Figure 6 and Text Table 2).

Text Table 2. Credit to Private Sector, 2003-04
(In billions of Malagasy francs, unless otherwise indicated)

	2003	2004				
	Dec.	Jun.	July	Aug.	Sep.	Oct.
Total loans	3,012.9	3,663.0	3,767.1	3,649.5	3,797.8	3,829.5
Of which : total credit to oil companies 1/	117.2	...	...	295.8	370.9	459.3
Total loans denominated in foreign exchange	177.4	364.2	324.8	235.4	208.1	191.3
Total loans excluding the effect of exchange rate depreciations in 2004	3,012.9	3,519.5	3,642.2	3,559.8	3,714.1	3,749.5
Guarantees deducted from risks 2/	92.9	306.8	396.4	322.7	329.0	350.3

Source: Banking and Financial Supervision Commission, Central Bank of Madagascar (BCM).
1/ Includes off balance sheet operations.
2/ These are guarantees provided for local subsidiary banks by their headquarters abroad. It excludes one local bank whose parent bank (abroad) guarantees all loans exceeding the single borrower exposure limit.

9. **The overall balance of payments is expected to be somewhat weaker than originally projected in 2004**, mainly as a result of lower-than-programmed disbursements of project grants. However, the current account balance is expected to improve relative to program projections, due to: (i) higher exports, reflecting in particular a lower-than-expected impact of the cyclones on the value of vanilla exports[7] and a strong increase in EPZ exports; and (ii) substantial increases in private transfers as a result of higher activity of NGOs operating in Madagascar.

10. **Implementation of the structural reform agenda has been uneven**. Progress has been achieved in the fight against corruption. The new anti-corruption bureau (BIANCO) started its operations in October 2004, and coordination between the various anti-corruption and control institutions (such as the High Council for the Fight Against Corruption, the General Accounting Office of the Supreme Court, and the General State Inspectorate) was strengthened. However, progress on public enterprise reform has been slow. The contract with one of the two operators selected last June to privately manage the sugar company, Sirama, was canceled in October, apparently because of disagreements over staffing issues, and awarded to the second operator selected in June. Moreover, while the company to privately manage the utility company, Jirama, has been selected and is expected to start its operations in early 2005, the medium-term strategy for the sector has not yet been finalized (LOI, ¶11).

[7] The volume of vanilla exports, however, declined substantially in 2004 and accounted for most of the 12 percent decline in the total volume of exports.

III. Report on Policy Discussions

11. **Macroeconomic policy remains geared toward fostering broad-based and sustained growth**. In this context, policy discussions centered on (i) assessing the economic environment for 2005, with a particular focus on inflation and on the possible impact of the termination of the International Multifibre Agreement (MFA) in early 2005; (ii) defining additional revenue measures to offset the expected shortfall stemming from various dispositions of the 2005 finance law and remedial actions to prevent the recurrence of expenditure overruns; (iii) securing a path for broad money consistent with the inflation objective and enhancing the effectiveness of monetary policy; (iv) preserving external debt sustainability in the wake of the attainment of the completion point under the enhanced HIPC Initiative; (v) accelerating structural reform implementation and diversifying economic activity in the context of increased competition for some of Madagascar's main export products; and (vi) stepping up capacity-building efforts.

A. Economic Outlook for 2005

12. **Real GDP is projected to reach 6.4 percent in 2005**, and should be driven by an increase in agricultural output and investment in tourism facilities and public infrastructure. The 6.4 percent growth target falls between the high and low projections in the poverty reduction strategy paper (PRSP).

13. **The authorities were confident that a substantial decline in inflation can be achieved in 2005**. They pointed to (i) the good rice harvest foreseen for 2005,[8] the projected decline in world market prices for rice, and the tariff reduction on imported rice; (ii) the gradual decrease, currently projected for 2005, of world market prices for oil from their high end-2004 level; and (iii) the waning effect of the exchange rate depreciation that took place in the first half of 2004. They remain committed to maintaining a tight policy stance, which should help contain the second-round effect of the 2004 CPI increase. Staff agreed that under these assumptions, the authorities' objective of lowering inflation to 5.5 percent (year-on-year) by December 2005, although ambitious, appeared achievable.[9]

14. **The authorities were of the view that containing inflation and accelerating the pace of structural reforms were paramount to preserving competitiveness at a time of increased competition**. In particular, with the termination of the MFA, textile exports are expected to grow only slightly in 2005. In this context, meeting the inflation target would be key to preserving competitiveness gains. At the same time, implementation of structural

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[8] With the strong increase in the price paid to domestic rice producers in 2004, areas under cultivation are expected to increase in 2005. Moreover, the extension of the road network in rice-growing areas should facilitate access to rice-producing centers.

[9] This represents a slight upward revision from the 5 percent foreseen in the finance law, which assumed a faster deceleration of world prices for oil, in line with earlier WEO projections.

reforms and of measures reinforcing good governance will have to be accelerated to foster an environment conducive to growth and economic diversification.

B. Fiscal Policy and Reform

15. **Fiscal policy in 2005 is geared toward supporting the dis-inflation objective, while preserving social spending**. The fiscal deficit—as measured by the domestic balance—is expected to improve by 1.6 percent of GDP in 2005 (LOI, ¶6). However, social expenditures are projected to increase markedly; excluding foreign-financed investment, health and education spending should grow by about 50 percent. The authorities concurred with the staff that maintaining a prudent wage policy, consistent with the 2005 finance law approved by the parliament, was key to bringing inflation down. However, they stressed that, at 4.6 percent of GDP, the wage bill is low by international standards and can constitute an obstacle to the recruitment of high caliber civil servants.[10] Staff agreed that this issue could be revisited in the future in the context of the civil service reform and mindful of macroeconomic implications. The substantial fiscal adjustment envisioned for 2005 should allow the government to reduce its indebtedness to the banking sector for the second year in a row.

16. **The ratio of tax revenue to GDP is targeted at 11.6 percent in 2005 and understandings were reached on a list of additional measures to offset the 2 point reduction in the value-added tax (VAT) rate and the reduction of some customs tariffs**. While the tax revenue target of 11.8 percent of GDP foreseen in the finance law could not be maintained, the revised target for 2005 still calls for a substantial improvement in the tax collection effort from 2004, equivalent to 0.6 percent of GDP, and is in line with PRSP projections. To meet this revised target, the authorities have decided to postpone the reduction in the VAT rate from 20 to 18 percent until September 1, 2005,[11] and additional revenue-enhancing measures will be implemented (Text Table 3 and LOI, Attachment II). In particular, the risk-management system at customs will be strengthened, the import tax on petroleum products will be increased to compensate for the shortfall from the reduction in the

Text Table 3. Expected Impact of Additional Revenue Measures in 2005
(In billions of FMG)

Total	305
Tax Directorate	
Intensification of tax verifications through enhanced cooperation with other fiscal administrations	80
Strengthen collection procedure on excise taxes	20
Strengthen taxation of real estate transactions	20
Customs Directorate	
Strengthen use of risk management system	185
Memorandum item	
Impact of VAT reduction on taxes collected on petroleum products 1/	-38

1/ Fully compensated by FMG 38 billion increase in taxes on petroleum products.

[10] The average size of the wage bill in Africa over 1990-2001 was 8.4 percent of GDP.

[11] The reduction will therefore coincide with the rescinding of the remaining tax and tariff exemptions granted in September 2003.

VAT collected on the products, and procedures will be implemented to systematize the exchange of information between the various fiscal administrations. The authorities have also announced their intention to explore ways, in consultation with their main development partners and, in particular, the World Bank, to improve the taxation of the mining sector, whose current contribution to the fiscal effort is very low, as pointed out in the PRSP.

17. **The authorities made substantial progress in customs reforms**. They increased the efficiency of customs procedures by intensifying ex post controls, instituted bi-weekly consultations with the private sector, and rotated more than 30 percent of customs agents in the past six months—changes that translated into a significant decrease in the average customs clearance time (from 48 to 24 hours or less in the main customs offices) and in discretionary decision making by customs officials, according to private sector representatives. The authorities explained that the revisions in customs tariffs envisaged in the 2005 finance law, which led to tariff reductions for over 200 goods, including rice, were part of a broader plan to rationalize customs tariffs within the four existing tariff bands (5, 10, 20, and 25 percent).[12] However, staff felt that the reclassification of goods within the four tariff bands was somewhat ad hoc and plans to explore the issue in further detail during the upcoming Article IV discussions.

18. **The authorities are firmly committed to implementing additional measures to strengthen budgetary execution and control in order to prevent a recurrence of expenditure slippages**. They have started to implement the measures already identified in the September 2004 MEFP, including the upward revision of some underbudgeted items in the 2005 finance bill and the transfer of oversight responsibility for the military wage bill to the Ministry of Finance, starting in January 2005. In addition, the Minister of Finance read a communication to the Council of Ministers about the strict limitation of the emergency expenditure procedure. Moreover, the authorities have asked the General State Inspectorate to carry out an audit of the use of the emergency procedure in 2004; the audit is expected to be completed by mid-March and could lead to administrative sanctions if warranted. The authorities are also committed to accelerating the implementation of the recommendations of the HIPC Assessment and Action Plan (AAP) report (LOI, ¶6, and Attachment I). Staff stressed that strengthening budgetary execution and control is of particular importance in 2005, the first year for program budgets.[13] The authorities were well aware of this particular challenge and are in the process of recruiting an international expert to help them strengthen budget execution and control. They also intended to put transitory safeguard mechanisms in place to smooth the transition to the program budget approach and prevent any losses in budgetary control.

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[12] The authorities are still evaluating the impact of the tariff revisions on the average weighted tariff.

[13] The most salient feature of program budgeting is to embed each annual budget in a rolling three-year expenditure framework, built on programs designed to achieve specific outcomes. The program budget for 2005 is built around 128 programs, those implementation is to be monitored by close to 1,500 output indicators.

C. Monetary and Exchange Rate Policies and Financial Sector Reform

19. **The main objective for monetary policy in 2005 is to secure a path of broad money consistent with the inflation target**. Broad money (M3) should increase by about 19 percent over the year as a whole, allowing for sufficient resources to be channeled to the private sector to support growth, with private sector credit projected to increase by about 22 percent, broadly in line with nominal GDP growth. The government's financing need from the banking system is projected to decline by 13 percent. The BCM will continue to hold regular reverse auctions to prevent excess liquidity buildup and stand ready to adapt monetary conditions if warranted by economic developments.

20. **The authorities recognize the need to improve the effectiveness of monetary policy to ensure that monetary targets can be met**. To this end, they plan to implement an operational framework for short-term liquidity forecasting and management with the assistance of the Fund's Monetary and Financial Systems Department (MFD). Meanwhile, liquidity forecasting procedures are also being improved through closer coordination with the Ministry of Finance. Furthermore, the authorities intend to broaden access to treasury bill auctions and ensure that appropriate conditions for money market developments are in place, with a view to improving the effectiveness of monetary policy (LOI, ¶7).

21. **The authorities will continue to allow the exchange rate to be market determined**. They consider that the new interbank foreign exchange market (MID), introduced in July 2004, has functioned smoothly and contributed to the stabilization of the exchange rate. In December 2004, the BCM adopted operational guidelines for its interventions in the MID, a structural benchmark under the program (LOI, ¶10). The guidelines reassert that the BCM would only intervene in the foreign exchange market to dampen sharp swings in the exchange rate and to meet the central bank's objective of net foreign assets accumulation—and, indeed, the BCM has largely refrained from foreign exchange interventions since mid-2004 (Figure 3 above). The authorities stress that the flexible exchange rate policy will be accompanied by prudent macroeconomic policies and structural reforms, with a view to maintaining Madagascar's external competitiveness. It was agreed that the forthcoming Article IV mission would look into these issues in more detail.

22. **The authorities plan to further strengthen banking supervision**. They noted that credit was expanding rapidly, partly reflecting foreign-owned banks' lending activity, backed by guarantees from their headquarters (Text Tables 2 and 4). Against this background, the authorities were taking steps to strengthen cooperation with supervisory authorities in banks' home countries.

23. **The authorities continue to implement the main recommendations of the Stage One safeguards assessment**. They have published the BCM's audited financial statements for 2003 and indicated that International Financial Reporting Standards will be adopted as the central bank's accounting framework starting in 2005. Furthermore, private sector firms are also set to adopt the new accounting framework in 2005, in line with the deadline set by

the National Accounting Board. On January 1, 2005, the transition from the Malagasy franc (FMG) to the ariary was smoothly extended to the entire payment system.

Text Table 4. Bank Soundness Indicators, December 2001 – September 2004

	2001	2002	2003	2004	
				Jun.	Sep. Est.
Capital adequacy			(Ratio, in percent)		
Regulatory capital to risk-weighted assets					
Lowest ratio	12.0	11.4	10.7	9.4	8.4
Highest ratio	34.1	38.7	38.5	49.1	38.7
Asset quality					
Nonperforming loans to total gross loans	10.3	19.5	16.7	14.2	12.9
Earnings and profitability					
Return on assets	2.8	1.1	3.2	4.3	4.4
Return on equity	39.0	16.0	45.7	33.4	...
Noninterest expenses to gross income	48.9	52.2	46.9	42.4	42.9
Personnel expenses to noninterest expenses	35.3	38.3	38.9	36.1	35.6
Liquidity					
Liquid assets to total assets	44.2	52.1	50.5	49.4	48.7
Liquid assets to short-term liabilities	70.0	77.8	74.5	71.8	70.3
			(In billions of Malagasy francs)		
Memorandum items					
Total assets	6,723.0	6,965.2	7,685.9	9,350.0	9,431.8
Total profits before tax	186.6	79.7	249.6	199.8	310.1
Highest foreign exchange exposure	17.2	19.6	58.3	141.0	109.4

Source: Banking and Financial Supervision Commission, Central Bank of Madagascar (BCM).

D. External Sector and Debt Sustainability Issues

24. **The current account deficit as a share of GDP is expected to narrow somewhat in 2005 relative to 2004, but considerable uncertainty remains**. First, the value of vanilla exports in 2005 may turn out to be lower than projected, in spite of the relatively good harvest and an expected sharp increase in the volume of exports, if the world market remains depressed. Moreover, the implications of the termination of the MFA, as well as the scheduled expiration of the third-party apparel provision of the African Growth Opportunity Act (AGOA III) in early 2007, on textile exports are also uncertain, and these exports are expected to grow in 2005 at a substantially lower pace than in 2004. There are also indications that export prices have been softening, in a context where profit margins are very

thin despite the recent depreciation of the Malagasy currency. With lower vanilla[14] and textile prices, the terms of trade are expected to show a sharp deterioration in 2005.

25. **Prudent borrowing and somewhat higher exports contributed to improvements in debt indicators in 2004, and most indicators for 2005 should be below the levels projected at the time of the completion point last October**. In the medium term however, lower vanilla prices and lower exports from EPZs relative to the projections at the completion point will raise the ratio of net present value of debt to exports by about 5 percentage points, but debt sustainability indicators are expected to remain below the HIPC thresholds. The authorities are making strong efforts to benefit fully from reaching the completion point under the enhanced HIPC Initiative and obtaining full HIPC assistance from their creditors (Box 1). External financing needs will, however, remain relatively high given the large infrastructure needs, but the authorities are committed to borrowing only on concessional terms following a careful analysis of the debt burden and repayment capacity (LOI, ¶9). The pressure for loan financing could be eased in the near future, provided Madagascar benefits from grants from the U.S. Millennium Challenge Account. Maintaining debt sustainability will also be helped by the strengthening of debt-management capacity, in the broader context of the stepped-up capacity-building effort (see ¶27 below).

Box 1. External Debt and the Paris Club Rescheduling

On November 16, 2004, Paris Club creditors concluded an agreement with the government of Madagascar on the provision of completion point assistance. The participating creditors were Austria, Canada, France, Germany, Israel, Italy, Japan, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Madagascar's public debt was estimated at US$4,843 million in nominal value at end-2003, and the debt owed to Paris Club creditors as of October 1, 2004, at US$1,572 million. The Paris Club provided debt relief of US$387 million in NPV terms, including interim assistance estimated at US$110 million. In addition, most Paris Club creditors have confirmed their intention to provide additional relief by canceling all remaining bilateral debt. The government of Madagascar has requested all its bilateral non Paris Club creditors to provide debt relief consistent with the enhanced HIPC Initiative.

[14] The 2005 forecast assumes an average export price of SDR 50 per kilo (compared with an average of SDR 180 per kilo in 2004), but there are indications that early 2005 transactions took place at a lower price. The decline in the price of vanilla accounts for most of the deterioration in the terms of trade projected for 2005.

E. Structural Reforms and Capacity Building Issues

26. **Improving overall competitiveness and diversifying the export base are among Madagascar's most important challenges**. To meet these challenges, the authorities intend to accelerate the implementation of structural reforms aimed at lowering the cost of production and raising the productivity of the export sector. They are of the view that continued vigorous implementation of the reform at customs is a key to success in this area. Staff made the point that clarifying the strategy for the utilities sector should also be considered a priority. The authorities intend to make progress toward the privatization of the two major public insurance companies (LOI, ¶11). More generally, they remain committed to implementing the recommendations of the recently completed Diagnostic Trade Integration Study, and, in consultation with the main stakeholders, to identifying specific measures aimed at improving competitiveness (LOI, ¶8). Increased transparency in public affairs, in particular through the actions of BIANCO, should also contribute to raise Madagascar's attractiveness to investors.

27. **The authorities agreed that meeting Madagascar's economic challenges and reducing its vulnerability to shocks also hinge on strengthening capacity in the area of economic policy formulation and implementation**. To this end, the authorities are preparing a time-bound capacity-building plan for several government institutions, including those that deal with public debt, expenditure execution and control, revenue, monetary management, and interventions in the interbank foreign exchange market. The government intends to approach its main development partners, including the Fund, in the course of 2005, to discuss possible support for the plan's implementation (LOI, ¶12).

IV. STAFF APPRAISAL

28. **Madagascar's performance under the program in 2004 has been broadly satisfactory, particularly in light of the difficult economic environment that prevailed during the first half of the year**. Efforts to stabilize the exchange rate proved successful, economic growth was sustained, and fiscal discipline was broadly maintained, with the domestic balance projected to improve by 1.5 percent of GDP in 2004. All quantitative performance criteria at end-September and the structural performance criterion at end-December have been met.

29. **Inflation continued to increase throughout 2004 and remains a key concern for 2005**. The 5.5 percent year-on-year inflation target for end-2005 could be achievable, provided that oil and rice prices moderate as expected and that the envisaged tight monetary and fiscal policies are fully implemented. Even if these conditions were in place, there remains a risk, however, that the inflation objective will not be met. The authorities are closely monitoring inflation developments and staff would be prepared to discuss possible options, should the deceleration in inflation indeed be slower than currently envisaged.

30. **In this context, the fiscal overruns that took place in the last quarter of 2004 were particularly regrettable, but the authorities' determination to avoid a recurrence**

of such slippages is welcome. The spending slippages underscore the need to accelerate ongoing reforms of the public expenditure management system, with a special emphasis on expenditure control. In this regard, the measures already taken by the authorities to address the weaknesses identified during the 2004 budget execution are an encouraging sign. The authorities should fully and timely implement the recommendations of the audit launched in January, because the strengthening of the budgetary process is crucial to maintain donor confidence and ensure the effectiveness of the budget as a poverty-reducing tool. The authorities should also put in place transitory safeguard mechanisms to ensure that the new program budget approach does not entail any loss in budgetary control.

31. **Performance at the customs department improved in the second half of 2004, with positive implications for both fiscal revenue and the business climate**. Continuation of the reform process will be essential to achieve the revenue target in 2005 and further improve Madagascar's attractiveness to investors.

32. **A simple, transparent, and predictable tax system has a critical role to play for fostering private sector led economic growth**. Ad hoc revisions to the tax and tariff system need to be avoided, especially where such revisions lead to a further erosion of revenues, which are low in relation to GDP. Instead, a more comprehensive approach is needed, ensuring that reductions in the rates are accompanied by a broadening of the tax base. The measures envisioned for 2005 to meet the revenue-to-GDP target of 11.6 percent, which include the rescinding of the remaining tax and tariff exemptions granted in 2003, a deepening of the cooperation between the relevant financial administrations, and the continuation of the anti-corruption drive, are welcome.

33. **Further steps are needed to strengthen monetary policy implementation**. In particular, while the ongoing improvement in liquidity forecasting is welcome, there is a strong case for the central bank to develop its monetary policy instruments and be more proactive in managing liquidity as well as monitor closely developments of monetary conditions in order to take prompt actions when needed.

34. **While employment in EPZs in 2004 is at historically high levels, the expiration of the MFA may have significant repercussions on textile exports**. These developments, combined with the prospect of the end of AGOA III in 2007, reinforce the need to preserve export competitiveness. Beyond maintaining competitiveness gains reached in 2004 through the depreciation of the exchange rate, reforms aimed at lowering production costs and promoting diversification, notably in the agro-based industry, need to be pursued.

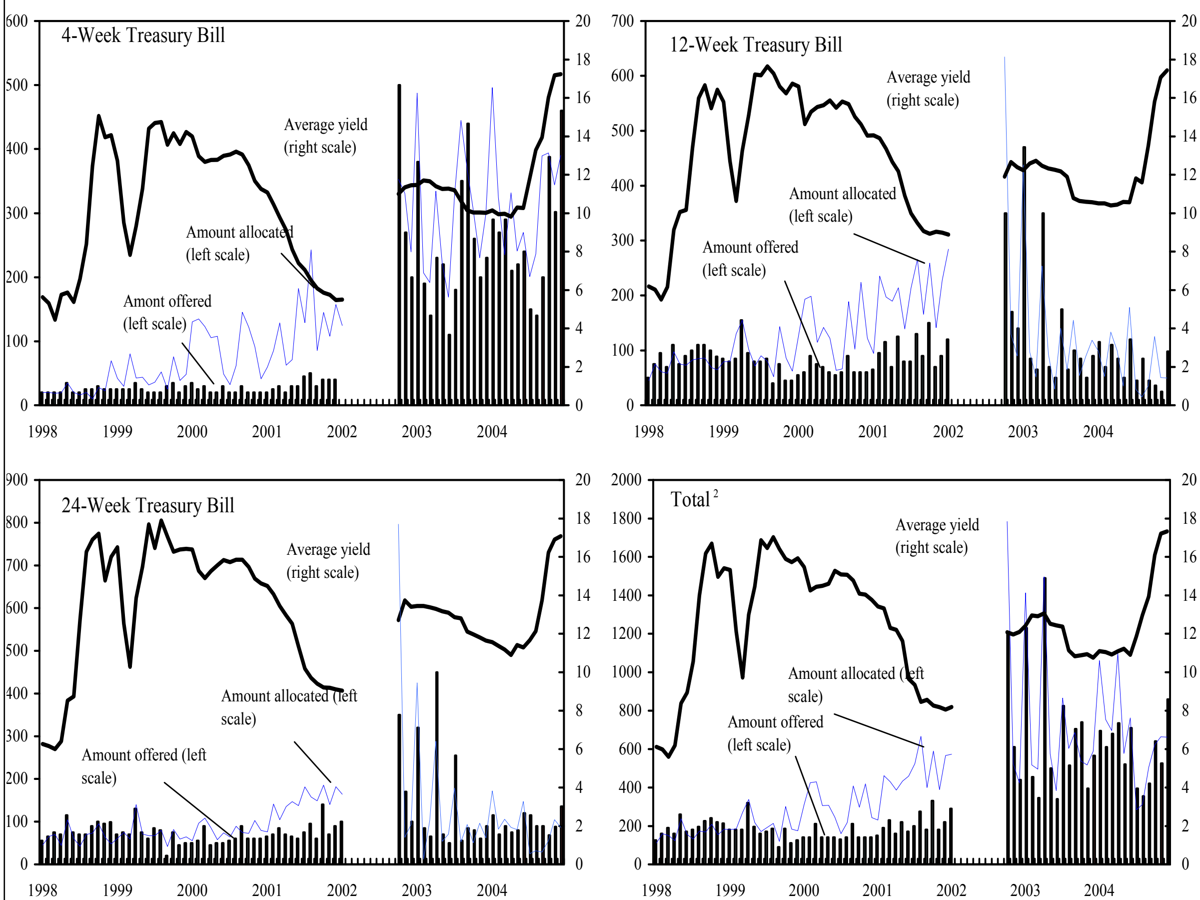
35. **Implementation of public enterprise reform, which has been uneven, needs to be accelerated**. In particular, a comprehensive strategy for the utilities sector should be developed, in consultation with the World Bank, and the roadmap for the privatization of the electricity and water company, which was recently been put under private management, should be finalized. Moreover, the privatization agenda could advance further in 2005, in particular in the insurance sector, which is dominated by public entities.

36. **Limited capacity continues to jeopardize the implementation of the country's reform program**. The authorities recognize the need to implement a time-bound action plan for capacity building in the areas of public debt and fiscal and monetary management and are in the process of finalizing it. The authorities should be approaching donors in 2005 to see how they could coordinate their support for the capacity building effort.

37. **Significant risks for macroeconomic stability remain**. Social tensions could rise, in particular in cities, if inflationary pressures do not abate and the price of rice does not decline as expected. Moreover, considerable uncertainties remain as to the evolution of the balance of payments, related notably to textile exports and vanilla prices. In this context, the success of Madagascar's economic strategy will hinge primarily on a steadfast implementation of the policy measures described above.

38. **In view of Madagascar's overall satisfactory record of program implementation, staff recommends the completion of the sixth review under the PRGF-supported program**. This would be the first time that Madagascar completes a PRGF arrangement with all disbursements scheduled thereunder having taken place. An Article IV mission is scheduled to take place in March 2005, combined with a discussion on the ex post assessment (EPA). The Malagasy authorities have expressed interest in pursuing their relationship with the Fund in the context of a successor PRGF arrangement.

Figure 5. Madagascar: Treasury Bill Auctions, January 1998–December 2004[1]
(Left scale in billions of Malagasy francs; right scale in percent)



Source: Malagasy authorities.

[1] No treasury bill auctions were conducted during March-September 2002.
[2] Sum of the 4-week, 12-week, 24-week, and 52-week treasury bills.

Table 1. Madagascar: Selected Economic and Financial Indicators, 2003-09 [1/]

	2003	2004		2005	2006	2007	2008	2009
		Prog. [2]	Proj.	Revised Projections				
(Annual percentage change, unless otherwise indicated)								
National income and prices								
Nominal GDP growth	12.8	16.4	20.3	21.9	12.3	11.5	11.5	11.2
Real GDP growth	9.8	5.3	5.3	6.4	7.0	6.3	6.3	6.0
GDP deflator	2.8	10.5	14.3	14.6	4.9	4.9	4.9	4.9
Consumer price index (period average)	-1.7	10.1	13.8	13.9	5.0	5.0	5.0	5.0
Consumer price index (end of period)	-0.8	14.9	27.0	5.5	5.0	5.0	5.0	5.0
External sector								
Export, f.o.b	79.4	-2.4	-7.7	8.5	6.8	8.4	8.0	7.5
Imports, c.i.f.	73.7	8.5	9.7	6.7	2.7	4.6	5.0	5.4
Export volume	64.0	-1.2	-11.9	46.1	5.1	5.9	5.4	4.8
Import volume	73.7	-5.3	0.5	2.9	4.7	6.2	6.3	6.2
Terms of trade (deterioration -) [3]	9.4	-13.9	-3.9	-28.3	3.6	3.9	3.9	3.4
Public finance								
Revenue (excluding grants)	45.4	35.0	41.4	22.7	16.4	15.5	14.5	14.2
Total expenditure	40.6	37.9	31.2	24.1	12.1	9.9	7.4	10.9
Current expenditure	24.1	18.6	25.9	10.2	8.8	14.4	11.1	13.9
Investment expenditure and net lending	72.7	64.7	38.6	41.9	15.3	5.8	3.8	7.6
Money and credit [4]								
Broad money	8.2	12.6	16.4	19.2	14.5	14.5	14.5	14.5
Net foreign assets	14.9	59.3	68.3	15.0	24.8	24.7	19.0	19.0
Net domestic assets	5.7	-6.6	-4.9	22.3	7.4	6.5	10.4	10.0
Credit to government [5]	13.7	-34.7	-35.5	-12.9	-20.6	-22.3	-24.0	-31.6
Credit to the private sector	22.2	22.2	28.6	22.1	23.0	23.8	22.5	22.3
Velocity of money (M3; average)	4.0	4.1	4.1	4.2	4.1	4.0	3.9	3.8
TB weighted-average auction rates								
(in percent; end of period)	10.8	...	...	...	...	...	...	...
(In percent of GDP)								
Public finance								
Total revenue (excluding grants)	10.3	12.0	12.1	12.2	12.6	13.1	13.4	13.8
Of which : tax revenue	10.0	11.2	11.0	11.6	12.1	12.6	13.0	13.4
Total grants	5.1	7.9	5.8	6.1	5.8	5.6	5.3	5.2
Capital expenditure	7.8	11.5	9.4	10.9	11.2	10.7	9.9	9.6
Total expenditure	19.5	23.1	21.3	21.7	21.7	21.4	20.6	20.5
Overall balance (commitment basis, incl. grants)	-4.2	-3.4	-3.5	-3.3	-3.2	-2.7	-1.8	-1.5
Overall balance (commitment basis, excl. grants)	-9.3	-11.3	-9.3	-9.5	-9.0	-8.3	-7.1	-6.7
Domestic financing	1.8	-1.1	-0.8	0.0	-0.5	-0.4	-0.3	-0.3

Table 1. Madagascar: Selected Economic and Financial Indicators, 2003-09 (concluded) [1/]

	2003	2004		2005	2006	2007	2008	2009
		Prog. [2]	Proj.	Revised Projections				
				(In percent of GDP)				
Money and credit [4]								
Broad money	25.1	24.3	24.3	23.8	24.2	24.9	25.6	26.3
Net foreign assets	7.3	10.0	10.2	9.7	10.7	12.0	12.8	13.7
Net domestic assets	17.8	14.3	14.1	14.1	13.5	12.9	12.8	12.6
Credit to government [5]	9.1	5.1	4.9	3.5	2.5	1.7	1.2	0.7
Credit to the private sector	8.8	9.2	9.4	9.4	10.3	11.4	12.6	13.8
Savings and investment								
Resource gap	-9.0	-15.2	-14.9	-13.3	-11.3	-10.2	-9.2	-8.4
Investment	17.9	23.7	24.4	24.9	24.7	24.1	23.2	22.9
Government	7.8	11.5	9.4	10.9	11.2	10.7	9.9	9.6
Nongovernment	10.1	12.2	15.0	14.0	13.5	13.4	13.3	13.3
Gross domestic savings	8.9	8.6	9.4	11.7	13.4	13.8	14.1	14.5
Gross national savings	13.0	14.6	15.9	16.8	18.3	18.4	18.4	18.6
Public	3.7	8.1	5.9	7.6	8.0	8.0	8.1	8.1
Private	9.3	6.4	10.0	9.2	10.3	10.5	10.2	10.5
External sector, public debt, and debt service								
Export, f.o.b	17.2	19.7	21.1	21.0	20.6	20.7	20.6	20.5
Imports, c.i.f.	24.3	33.5	35.5	34.7	32.7	31.7	30.7	30.0
Current account balance (excluding grants)	-7.5	-13.2	-12.2	-10.8	-8.9	-7.9	-7.0	-6.3
Current account balance (including grants)	-4.9	-9.2	-8.5	-8.2	-6.4	-5.6	-4.9	-4.3
Net present value (NPV) of external debt (after enhanced HIPC debt relief)								
NPV of debt-to-GDP ratio	61.7	50.6	51.6	48.3	46.8	45.3	43.3	41.4
NPV of debt-to-exports ratio [6]	305.7	213.5	204.7	177.1	172.3	164.7	158.0	151.5
				(In units indicated)				
Gross official reserves (in millions of SDRs)	284.6	327.5	325.6	342.2	394.7	454.3	506.4	564.8
In months of imports of goods and nonfactor services	2.7	3.0	3.0	3.0	3.3	3.6	3.8	4.1
Exchange rate: Malagasy francs per SDR (period average)	8,646.0	...	13,860.4	...	...	...	...	...
Exchange rate: Malagasy francs per U.S. dollar (period average)	6,203.4	...	9,354.1	...	...	...	...	...
GDP per capita (in U.S. dollars)	324	255	251	276	292	306	322	337
Nominal GDP (billions of Malagasy francs)	33,893	39,446	40,778	49,712	55,808	62,241	69,415	77,198

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

[1] Data may not add up due to rounding.
[2] IMF Country Report No. 04/404, (9/30/04).
[3] Based on 1993 trade weights.
[4] The composition of monetary growth in 2003 reflects reclassification of a public enterprise, SOLIMA, debt (FMG 350.4 billion) by the government.
[5] For 2003, include the takeover of SOLIMA debt by the government.
[6] Based on the average of three consecutive years of exports of goods and services ending in the current year. (e.g., export average over 2001-2003 for NPV of debt-to-exports ratio in 2003).

Table 2. Madagascar. Quarterly Central Government Accounts, 2004-05
(In billions of Malagasy Francs)

	2004								2005			
	Q1		Q2		Q3		Q4		Q1	Q2	Q3	Q4
	Prog. 1/	Act.	Prog. 1/	Est.	Prog. 1/	Est.	Prog. 1/	Rev.Proj.	Revised Projections			
Total revenue and grants	1,325.8	1,358.1	2,981.4	3,035.9	5,858.5	5,527.3	7,826.8	7,309.0	2,107.0	4,643.6	7,192.8	9,119.3
Total revenue	1,090.5	1,077.3	2,309.7	2,283.3	3,420.6	3,448.8	4,717.3	4,940.5	1,470.7	3,164.8	4,588.5	6,062.0
Of which: tax revenue	1,010.5	997.6	2,164.3	2,125.6	3,191.3	3,222.9	4,417.9	4,482.9	1,381.3	2,995.6	4,346.2	5,756.7
Grants	235.3	280.9	671.7	752.6	2,437.9	2,078.5	3,109.5	2,368.5	636.3	1,478.8	2,604.3	3,057.3
Current grants	69.0	61.4	228.2	258.5	1,206.1	1,331.1	1,450.0	1,444.9	150.5	312.9	952.6	1,114.1
Of which: HIPC assistance	53.3	56.1	92.3	61.4	138.9	128.9	180.8	180.8	103.2	177.4	278.5	354.2
counterpart funds	15.7	5.3	28.2	28.2	36.5	66.8	46.3	80.4	9.0	12.7	16.1	17.4
Project grants	166.3	219.5	443.5	494.1	1,231.8	747.3	1,659.5	923.7	485.8	1,165.9	1,651.7	1,943.2
Total expenditure	1,417.6	1,790.7	3,285.3	4,076.6	6,817.4	6,472.1	9,130.4	8,689.2	2,674.0	5,682.4	8,449.5	10,787.4
Current expenditure	957.6	959.6	2,100.4	2,248.8	3,467.7	3,554.4	4,577.2	4,859.2	1,179.5	2,600.7	4,163.3	5,353.2
Budgetary expenditure	914.2	887.0	1,949.5	2,056.6	3,233.2	3,169.2	4,410.9	4,473.3	1,151.1	2,541.3	4,037.0	5,192.1
Personnel	482.8	433.9	965.7	905.4	1,448.5	1,426.1	1,931.3	2,009.9	532.1	1,098.2	1,687.8	2,287.9
Of which: HIPC financed	29.9	29.9	59.9	47.5	89.8	87.0	119.7	119.7	41.1	84.8	130.4	176.7
Other noninterest expenditure	216.6	193.6	552.9	553.8	944.2	1,004.8	1,277.1	1,346.1	316.5	738.5	1,431.9	1,582.3
Of which: HIPC financed	13.7	13.7	28.8	16.0	63.0	24.3	101.8	101.8	22.5	56.0	89.5	112.3
Foreign interest obligations	71.1	87.9	177.2	256.3	380.7	290.7	560.7	479.4	115.0	331.5	439.1	658.1
Domestic interest obligations	143.7	171.6	253.8	341.1	459.8	447.6	641.8	637.9	187.5	373.1	478.2	663.8
Treasury operations (net) [2]	41.8	71.3	147.7	190.3	230.3	382.1	160.5	380.1	26.4	55.4	119.3	152.1
Counterpart funds-financed operations	1.6	1.3	3.2	2.0	4.2	3.0	5.8	5.8	2.0	4.0	7.0	9.0
Capital expenditure	460.0	831.1	1,184.9	1,827.8	3,349.7	2,917.7	4,553.2	3,830.0	1,494.5	3,081.7	4,286.2	5,434.3
Domestically financed	126.7	224.6	309.5	515.7	870.0	853.6	1,200.0	1,170.2	279.0	642.4	936.7	1,368.8
Of which: cyclone related expenditures	0.0	100.0	0.0	100.0	100.0	101.0	100.0	100.0	0.0	0.0	0.0	0.0
Foreign financed	333.3	606.6	875.4	1,312.1	2,479.7	2,064.1	3,353.2	2,659.8	1,215.5	2,439.3	3,349.5	4,065.5
Of which: HIPC financed	23.3	23.3	48.8	56.5	78.9	79.2	95.0	95.0	78.5	157.0	209.4	261.7
Government on-lending to public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net cost of structural reforms	-8.1	-22.8	-26.3	-22.8	-25.0	-46.0	-42.7	-42.7	2.3	4.5	6.8	9.0
Overall balance (commitment basis)												
Excluding grants	-335.2	-736.3	-1,001.9	-1,816.1	-3,421.8	-3,069.2	-4,455.8	-3,791.4	-1,201.1	-2,513.1	-3,854.3	-4,716.4
Including grants	-99.8	-455.4	-330.2	-1,063.5	-983.9	-990.7	-1,346.3	-1,422.8	-564.8	-1,034.3	-1,250.0	-1,659.2
Domestic balance (commitment basis) [3]	69.3	-41.8	50.6	-247.7	-561.5	-714.4	-541.9	-652.2	129.4	257.7	-65.6	7.1
Change in arrears [4]	-140.8	-230.0	-175.3	-271.6	-287.0	-216.9	-347.3	-347.3	-100.0	-120.0	-205.0	-205.0
Total overall balance (cash basis, excluding grants)	-476.0	-966.3	-1,177.2	-2,087.7	-3,708.8	-3,286.1	-4,803.1	-4,138.7	-1,301.1	-2,633.1	-4,059.3	-4,921.4
Total overall balance (cash basis, including grants)	-240.6	-685.4	-505.5	-1,335.1	-1,270.9	-1,207.6	-1,693.6	-1,770.1	-664.8	-1,154.3	-1,455.0	-1,864.2

Table 2. Madagascar. Quarterly Central Government Accounts, 2004-05 (concluded)
(In billions of Malagasy Francs)

	2004								2005			
	Q1		Q2		Q3		Q4		Q1	Q2	Q3	Q4
	Prog. 1/	Act.	Prog. 1/	Est.	Prog. 1/	Est.	Prog. 1/	Rev. Proj.	Revised Projections			
Financing	240.6	685.4	505.5	1,335.1	1,270.9	1,207.6	1,693.6	1,770.1	664.8	1,154.3	1,454.9	1,864.2
Foreign (net)	183.1	540.8	221.5	977.9	1,534.2	1,643.0	2,005.8	1,948.7	716.9	1,203.5	1,622.9	2,000.8
Drawings	303.9	599.2	543.3	1,053.6	1,757.0	1,933.9	2,283.0	2,362.2	805.8	1,425.6	1,952.3	2,479.0
Budget	160.3	235.5	160.3	235.6	588.1	617.0	684.2	721.1	154.6	309.2	463.8	618.4
Projects	143.6	363.7	383.0	818.0	1,169.0	1,316.8	1,598.7	1,641.1	651.2	1,116.4	1,488.5	1,860.6
Amortization due	-120.8	-136.9	-321.8	-301.6	-517.5	-534.4	-727.2	-859.3	-199.3	-502.8	-678.0	-999.1
Change in external arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	65.9	78.5	185.2	225.9	294.7	243.5	450.0	445.7	110.3	280.7	348.6	520.9
Current maturities	53.5	66.1	122.2	162.9	224.1	172.9	328.5	324.2	71.4	160.3	197.8	324.4
HIPC assistance	12.4	12.4	63.0	63.0	70.6	70.6	121.5	121.5	38.9	120.4	150.8	196.5
Domestic (net)	55.3	134.5	260.6	230.1	-390.4	-564.3	-448.3	-331.5	-52.1	-49.2	-168.4	-145.5
Banking system [5]	-79.8	-76.3	175.2	-133.2	-953.9	-1,070.0	-1,013.4	-1,031.4	-75.0	-95.0	-237.2	-237.2
Nonbanking system	135.1	77.0	85.4	134.0	438.1	301.3	478.1	539.9	22.9	45.9	68.8	91.7
Treasury correspondent accounts (net)	0.0	133.8	0.0	229.3	125.4	204.4	87.0	160.0	0.0	0.0	0.0	0.0
Privatization receipts	2.2	10.1	23.4	127.1	127.1	128.9	136.1	153.0	0.0	0.0	0.5	8.9

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] IMF Country Report No. 04/404, (09/30/04).

[2] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, and civil service retirement funds.

[3] Overall balance, excluding grants, foreign-financed capital expenditures, and foreign interest payments.

[4] Change in arrears consists of the amount to be recommitted and net payments delays. The latter includes expenditure committed but with no payment order issued, an item not covered by the performance criterion on non-accumulation of arrears.

[5] Excludes the effect of exchange rate changes on net credit to the government in foreign exchange.

Table 3. Madagascar: Central Government Accounts, 2003-09
(In billions of Malagasy francs)

	2003	2004		2005	2006	2007	2008	2009
		Prog. 1/	Rev.Proj.	Revised projections				
Total revenue and grants	5,224.8	7,826.8	7,309.0	9,119.3	10,311.7	11,629.4	13,039.9	14,651.1
Total revenue	3,494.5	4,717.3	4,940.5	6,062.0	7,056.0	8,147.1	9,332.4	10,658.5
Budgetary revenue	3,494.5	4,717.3	4,940.5	6,062.0	7,056.0	8,147.1	9,332.4	10,658.5
Tax revenue	3,392.3	4,417.9	4,482.9	5,756.7	6,752.7	7,842.3	9,023.9	10,344.5
Nontax revenue	108.0	299.4	457.6	305.3	303.3	304.8	308.5	314.0
Grants	1,730.3	3,109.5	2,368.5	3,057.3	3,255.7	3,482.3	3,707.5	3,992.6
Current grants	859.3	1,450.0	1,444.9	1,114.1	1,208.9	1,264.8	1,307.4	1,400.7
Of which: HIPC assistance	191.6	180.8	180.8	354.2	429.4	425.3	404.2	431.0
Project grants	871.0	1,659.5	923.7	1,943.2	2,046.8	2,217.5	2,400.1	2,591.9
Total expenditure	6,622.2	9,130.4	8,689.2	10,787.4	12,090.1	13,290.4	14,280.4	15,835.2
Current expenditure	3,858.3	4,577.2	4,859.2	5,353.2	5,824.0	6,660.8	7,397.6	8,426.4
Budgetary expenditure	3,758.2	4,410.9	4,473.3	5,192.1	5,721.0	6,557.8	7,294.6	8,323.4
Personnel	1,827.1	1,931.3	2,009.9	2,287.9	2,678.8	3,074.7	3,366.6	3,805.9
Of which: HIPC financed	119.8	119.7	119.7	176.7	...	...	...	...
Other noninterest expenditure	1,180.7	1,277.1	1,346.1	1,582.3	1,971.6	2,410.5	2,855.0	3,437.6
Of which: HIPC financed	119.7	101.8	101.8	112.3	0.0	0.0	0.0	0.0
Foreign interest obligations	302.8	560.7	479.4	658.1	655.3	689.7	720.2	751.1
Domestic interest obligations	447.5	641.8	637.9	663.8	415.3	382.9	352.9	328.9
Treasury operations (net) [2]	60.4	160.5	380.1	152.1	100.0	100.0	100.0	100.0
Emergency expenditure	35.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Counterpart-funds-financed operations	4.3	5.8	5.8	9.0	3.0	3.0	3.0	3.0
Capital expenditure	2,657.4	4,553.2	3,830.0	5,434.3	6,266.0	6,629.6	6,882.8	7,408.8
Domestically financed	861.4	1,200.0	1,170.2	1,368.8	2,125.8	2,434.1	2,747.3	3,080.0
Foreign financed	1,796.0	3,353.2	2,659.8	4,065.5	4,140.3	4,195.5	4,135.5	4,328.8
Of which: HIPC financed	123.4	95.0	95.0	261.7	...	...	...	...
Government on-lending	106.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance [3]	386.6	1,168.9	1,044.9	1,930.5	2,166.7	2,440.8	2,907.6	3,229.7
Overall balance (commitment basis, excluding the cost of structural reforms)								
Including grants	-1,397.4	-1,303.6	-1,380.1	-1,668.2	-1,778.4	-1,661.0	-1,240.5	-1,184.1
Excluding grants	-3,127.7	-4,413.1	-3,748.7	-4,725.4	-5,034.0	-5,143.3	-4,948.0	-5,176.7
Net cost of structural reforms [4]	-19.7	-42.7	-42.7	9.0	0.0	0.0	0.0	0.0
Exceptional revenue	6.1	7.3	7.3	9.0	0.0	0.0	0.0	0.0
Cost of structural reforms	25.7	50.0	50.0	0.0	0.0	0.0	0.0	0.0

Table 3. Madagascar: Central Government Accounts, 2003-09 (concluded)
(In billions of Malagasy francs)

	2003	2004		2005	2006	2007	2008	2009
		Prog. 1/	Rev. Proj.	Revised Projections				
Overall balance (commitment basis, including the cost of structural reforms)								
Excluding grants	-3,147.4	-4,455.8	-3,791.4	-4,716.4	-5,034.0	-5,143.3	-4,948.0	-5,176.7
Including grants	-1,417.1	-1,346.3	-1,422.8	-1,659.2	-1,778.4	-1,661.0	-1,240.5	-1,184.1
Domestic balance [5]	-1,048.5	-541.9	-652.2	7.1	-238.4	-258.1	-92.3	-96.8
Change in arrears	-204.9	-347.3	-347.3	-205.0	-100.0	-50.0	-50.0	-50.0
Total overall balance (cash basis, excluding grants)	-3,352.3	-4,803.1	-4,138.7	-4,921.4	-5,134.0	-5,193.3	-4,998.0	-5,226.7
Total overall balance (cash basis, including grants)	-1,622.0	-1,693.6	-1,770.1	-1,864.2	-1,878.4	-1,711.0	-1,290.5	-1,234.1
Financing	1,622.0	1,693.6	1,770.1	1,864.2	1,878.4	1,711.0	1,290.5	1,234.1
Foreign (net)	957.8	2,005.8	1,948.7	2,000.8	2,148.4	1,961.0	1,490.5	1,434.1
Drawings	1,246.3	2,283.0	2,362.2	2,479.0	2,732.7	2,637.3	2,244.9	2,262.0
Budget	321.3	684.2	721.1	618.4	639.2	659.3	509.5	525.0
Projects	925.0	1,598.7	1,641.1	1,860.6	2,093.5	1,978.0	1,735.4	1,737.0
Amortization due	-634.4	-727.2	-859.3	-999.1	-960.7	-894.6	-993.5	-1,085.7
Change in external arrears	-67.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt relief	413.2	450.0	445.7	520.9	376.4	218.3	239.1	257.8
Of which: HIPC assistance	133.7	121.5	121.5	196.5	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(in millions of U.S. dollars)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	596.5	-448.3	-331.5	-145.5	-270.0	-250.0	-200.0	-200.0
Banking system [6]	43.9	-1,013.4	-1,031.4	-237.2	-350.0	-300.0	-250.0	-250.0
Nonbanking system	422.6	478.1	539.9	91.7	80.0	50.0	50.0	50.0
Treasury correspondent accounts (net)	130.0	87.0	160.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	67.7	136.1	153.0	8.9	0.0	0.0	0.0	0.0
Memorandum items:								
Total domestic debt	5,431.5	5,084.0	5,084.0	4,938.6	4,668.6	4,418.6	4,218.6	4,018.6
Social spending	1,344.0	1,907.7	1,608.2	2,678.9	...	...	...	...

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] IMF Country Report No. 04/404, (09/30/04).
[2] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities.
[3] Defined as total revenue (excluding non-tax revenues from the central bank) minus current expenditure (excluding domestic and foreign interest payments).
[4] The net cost of structural reforms comprises (a) as receipts, loan recovery by the debt-recovery unit that holds the nonperforming loans of the two (former) public banks (BFV and BTM) after the financial restructuring of their assets; and (b) as expenditures, those related to civil service reform (i.e., training, bonuses, and wage decompression); to the upgrading of pay and equipment in the justice services; to privatization (severance pay, administrative costs, transfers to the regional development fund that provides grants and concessional loans for basic social infrastructure purposes or to employees affected by privatization, and indemnization payments to formerly expropriated owners); and to the capital transfers for the asset restructuring at the two insolvent banks (BFV and BTM).
[5] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.
[6] Excludes the effect of exchange rate changes on net credit to government in foreign exchange.

Table 4. Madagascar: Central Government Accounts, 2003-09
(In percent of GDP, unless otherwise indicated)

	2003	2004		2005	2006	2007	2008	2009
		Prog. 1/	Rev. Proj.	Revised projections				
Total revenue and grants	15.4	19.8	17.9	18.3	18.5	18.7	18.8	19.0
Total revenue	10.3	12.0	12.1	12.2	12.6	13.1	13.4	13.8
Tax revenue	10.0	11.2	11.0	11.6	12.1	12.6	13.0	13.4
Nontax revenue	0.3	0.8	1.1	0.6	0.5	0.5	0.4	0.4
Grants	5.1	7.9	5.8	6.1	5.8	5.6	5.3	5.2
Current grants	2.5	3.7	3.5	2.2	2.2	2.0	1.9	1.8
Of which: HIPC assistance	0.6	0.5	0.4	0.7	0.8	0.7	0.6	0.6
Project grants	2.6	4.2	2.3	3.9	3.7	3.6	3.5	3.4
Total expenditures	19.5	23.1	21.3	21.7	21.7	21.4	20.6	20.5
Current expenditure	11.4	11.6	11.9	10.8	10.4	10.7	10.7	10.9
Noninterest expenditure	8.9	8.1	8.2	7.8	8.3	8.8	9.0	9.4
Personnel	5.4	4.9	4.9	4.6	4.8	4.9	4.9	4.9
Of which: HIPC financed	0.4	0.3	0.3	0.4	...	...	...	...
Other noninterest expenditure	3.5	3.2	3.3	3.2	3.5	3.9	4.1	4.5
Of which: HIPC financed	0.4	0.3	0.2	0.2	0.0	0.0	0.0	0.0
Interest obligations	2.2	3.0	2.7	2.7	1.9	1.7	1.5	1.4
Treasury operations [2]	0.2	0.4	0.9	0.3	0.2	0.2	0.1	0.1
Emergency expenditures	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	7.8	11.5	9.4	10.9	11.2	10.7	9.9	9.6
Domestically financed expenditure	2.5	3.0	2.9	2.8	3.8	3.9	4.0	4.0
Foreign-financed expenditure	5.3	8.5	6.5	8.2	7.4	6.7	6.0	5.6
Of which: HIPC financed	0.4	0.2	0.2	0.5	...	...	...	...
Government on-lending	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic budgetary balance	-2.7	-1.3	-1.5	0.0	-0.4	-0.4	-0.1	-0.1
Primary balance [3]	1.1	3.0	2.6	3.9	3.9	3.9	4.2	4.2
Net cost of structural reforms [4]	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Exceptional revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cost of structural reforms	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis)								
Excluding grants	-9.3	-11.3	-9.3	-9.5	-9.0	-8.3	-7.1	-6.7
Including grants	-4.2	-3.4	-3.5	-3.3	-3.2	-2.7	-1.8	-1.5
Domestic balance [5]	-3.1	-1.4	-1.6	0.0	-0.4	-0.4	-0.1	-0.1
Change in arrears	-0.6	-0.9	-0.9	-0.4	-0.2	-0.1	-0.1	-0.1
Total overall balance (cash basis, excluding grants)	-9.9	-12.2	-10.1	-9.9	-9.2	-8.3	-7.2	-6.8
Total overall balance (cash basis, including grants)	-4.8	-4.3	-4.3	-3.7	-3.4	-2.7	-1.9	-1.6

Table 4. Madagascar: Central Government Accounts, 2003-09 (concluded)
(In percent of GDP, unless otherwise indicated)

	2003	2004		2005	2006	2007	2008	2009
		Prog. 1/	Rev. Proj.	Revised Projections				
Financing	4.8	4.3	4.3	3.7	3.4	2.7	1.9	1.6
Foreign (net)	2.8	5.1	4.8	4.0	3.8	3.2	2.1	1.9
Drawings	3.7	5.8	5.8	5.0	4.9	4.2	3.2	2.9
Budget	0.9	1.7	1.8	1.2	1.1	1.1	0.7	0.7
Projects	2.7	4.1	4.0	3.7	3.8	3.2	2.5	2.3
Amortization due	-1.9	-1.8	-2.1	-2.0	-1.7	-1.4	-1.4	-1.4
Change in external arrears	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt relief	1.2	1.1	1.1	1.0	0.7	0.4	0.3	0.3
Of which: HIPC assistance	0.4	0.3	0.3	0.4	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	1.8	-1.1	-0.8	-0.3	-0.5	-0.4	-0.3	-0.3
Of which: banking system [6]	0.1	-2.6	-2.5	-0.5	-0.6	-0.5	-0.4	-0.3
Privatization receipts	0.2	0.3	0.4	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Total domestic debt	16.0	12.5	12.5	9.9	8.4	7.1	6.1	5.2
Social expenditure	4.0	4.8	3.9	5.4	...	...	...	...
Nominal GDP (in billions of Malagasy francs)	33,893	39,446	40,778	49,712	55,808	62,241	69,415	77,198

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] IMF Country Report No. 04/404, (09/30/04).
[2] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities.
[3] Defined as total revenue (excluding non-tax revenues from the central bank) minus current expenditure (excluding domestic and foreign interest payments).
[4] The net cost of structural reforms comprises (a) as receipts, loan recovery by the debt-recovery unit that holds the nonperforming loans of the two (former) public banks (BFV and BTM) after the financial restructuring of their assets; and (b) as expenditures, those related to civil service reform (i.e., training, bonuses, and wage decompression); to the upgrading of pay and equipment in the justice services; to privatization (severance pay, administrative costs, transfers to the regional development fund that provides grants and concessional loans for basic social infrastructure purposes or to employees affected by privatization, and indemnization payments to formerly expropriated owners); and to the capital transfers for the asset restructuring at the two insolvent banks (BFV and BTM).
[5] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.
[6] Excludes the effect of exchange rate changes on net credit to government in foreign exchange.

Table 5. Madagascar: Monetary Survey, 2003-05
(In billions of Malagasy francs, unless otherwise indicated)

	2003	2004				2005				
	Dec.	Sep.		Dec.		Mar.	Jun.	Sep.	Dec.	
		Prog. 1/	Act.	Prog. 1/	Proj.	Proj.	Proj.	Proj.	Proj. 1/	Rev. Proj.
Net foreign assets	2,479.3	4,163.7	4,756.1	3,949.0	4,173.4	4,675.2	4,675.2	4,721.8	4,646.1	4,799.5
Net foreign assets (BCM)	1,424.0	2,556.1	3,043.1	2,342.7	2,443.2	2,741.1	2,741.1	2,741.1	2,763.7	2,741.1
Net foreign assets (domestic money banks)	1,055.3	1,607.6	1,713.0	1,606.2	1,730.2	1,934.1	1,934.1	1,980.7	1,882.3	2,058.4
Net domestic assets	6,043.4	5,339.2	5,102.9	5,645.5	5,745.2	6,086.6	6,330.9	6,783.9	6,195.7	7,023.6
Domestic credit	6,509.5	6,203.4	6,257.3	6,136.9	6,327.2	6,542.8	6,674.5	6,795.9	6,847.4	6,915.3
Net credit to government (budget)	3,078.4	2,071.1	2,030.1	2,011.6	1,985.2	1,890.8	1,870.8	1,728.6	1,915.4	1,728.7
Other claims on public sector	410.5	424.8	450.5	424.8	446.7	446.7	446.7	446.7	424.8	446.7
Credit to the economy	3,020.6	3,707.6	3,776.7	3,700.5	3,895.3	4,205.3	4,357.0	4,620.5	4,507.2	4,739.9
Credit to public enterprises	46.2	66.2	66.0	66.2	69.8	69.8	69.8	69.8	66.2	69.8
Credit to private sector	2,974.5	3,641.4	3,710.7	3,634.3	3,825.5	4,135.5	4,287.2	4,550.8	4,441.0	4,670.1
Other items (net; asset +)	-466.1	-864.2	-1,154.4	-491.4	-581.9	-456.2	-343.6	-12.0	-651.6	108.3
M3	8,522.8	9,502.9	9,859.0	9,594.5	9,918.7	10,761.8	11,006.1	11,505.7	10,841.8	11,823.1
Foreign currency deposits	1,086.9	1,578.4	1,788.1	1,578.4	1,710.9	1,912.5	1,912.5	1,912.5	1,849.8	1,912.5
M2	7,435.9	7,924.5	8,070.9	8,016.1	8,207.8	8,849.3	9,093.6	9,593.2	8,992.0	9,910.6
Currency in circulation	2,570.0	2,565.8	2,725.6	2,590.5	2,767.3	3,002.5	3,070.7	3,210.1	2,927.3	3,298.6
Deposits in local currency	4,688.7	5,203.0	5,215.5	5,262.9	5,308.3	5,714.6	5,890.7	6,251.0	5,902.1	6,479.8
Short-term obligations of commercial banks	177.2	155.7	129.8	162.6	132.2	132.2	132.2	132.2	162.6	132.2
Memorandum items:	the previous year, unless otherwise indicated)									
M3	8.2	11.5	15.7	12.6	16.4	8.5	11.0	16.0	13.0	19.2
M2	6.3	6.6	8.5	7.8	10.4	7.8	10.8	16.9	12.2	20.7
Domestic credit	9.4	-4.7	-3.9	-5.7	-2.8	3.4	5.5	7.4	11.6	9.3
Credit to the private sector	22.2	22.4	24.8	22.2	28.6	8.1	12.1	19.0	22.2	22.1
Net credit to government 2/	13.7	-32.7	-34.1	-34.7	-35.5	-4.8	-5.8	-12.9	-4.8	-12.9
Reserve money	-0.3	-2.3	-0.9	-1.4	11.7	8.4	10.8	15.6	12.5	18.6
Currency/M3 (in percent)	30.2	27.0	27.6	27.0	27.9	27.9	27.9	27.9	27.0	27.9
Reserve money multiplier (M3/reserves)	2.4	2.8	2.8	2.8	2.5	2.5	2.5	2.5	2.8	2.5
Velocity of money (GDP/end-of-period M3)	4.0	...	...	4.1	4.1	...	...	...	4.2	4.2
Exchange rate (Malagasy francs per SDR; end of period) 3/	9,027.0	13,739.3	15,233.4	13,739.3	14,478.4	16,184.6	16,184.6	16,184.6	16,100.9	16,184.6

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

1/ IMF Country Report No. 04/404, (9/30/04).
2/ 2003 includes the takeover of state oil company (SOLIMA) debt (FMG 350.4 billion) by the government.
3/ Exchange rate for monetary programming purposes.

Table 6. Madagascar: Balance Sheet of the Central Bank (BCM), 2003-05
(In billions of Malagasy francs, unless otherwise indicated)

	2003	2004					2005				
	Dec.	Jun.	Sep.		Dec.		Mar.	Jun.	Sep.	Dec.	
			Prog. 1/	Act.	Prog. 1/	Proj.	Proj.	Proj.	Proj.	Proj. 1/	Rev. Proj.
Net foreign assets	1,424.0	2,187.2	2,556.1	3,043.1	2,342.7	2,443.2	2,741.1	2,741.1	2,741.1	2,763.7	2,741.1
Net domestic assets	2,100.6	1,199.9	889.0	449.6	1,132.4	1,492.9	1,526.7	1,619.3	1,808.7	1,146.9	1,929.1
Overall credit to government (net)	1,697.4	1,453.2	1,178.8	1,006.0	1,219.4	1,161.2	1,066.8	1,046.8	904.6	1,219.4	904.7
Liquidity operations 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net credit to government (budget) 3/	1,697.4	1,453.2	1,178.8	1,006.0	1,219.4	1,161.2	1,066.8	1,046.8	904.6	1,219.4	904.7
Claims on public enterprises 3/	17.7	19.4	18.1	19.5	18.1	19.2	19.2	19.2	19.2	18.1	19.2
Credit to banks	17.2	13.4	15.5	-342.3	15.5	12.7	12.7	12.7	12.7	15.5	12.7
Other items (net; asset +)	368.3	-286.0	-323.4	-233.6	-120.6	299.8	428.0	540.6	872.2	-106.1	992.5
Of which : valuation account (losses -)	-6.9	-836.3	-754.6	-851.0	-755.5	-873.2	-1,162.4	-1,162.4	-1,162.4	-1,161.4	-1,163.1
Reserve money 4/	3,524.6	3,387.1	3,445.1	3,492.7	3,475.1	3,936.1	4,267.7	4,360.4	4,549.8	3,910.6	4,670.1
Currency outside banks	2,570.0	2,648.8	2,565.8	2,725.6	2,590.5	2,767.3	3,002.5	3,070.7	3,210.1	2,927.3	3,298.6
Bank reserves	954.6	738.2	879.4	767.2	884.6	1,168.8	1,265.2	1,289.7	1,339.7	983.3	1,371.5
Currency in banks	150.8	167.5	175.8	170.7	175.8	172.4	181.8	181.8	181.8	180.2	181.8
Deposits	803.9	570.8	703.6	596.5	708.8	996.4	1,083.4	1,107.9	1,157.9	803.1	1,189.7

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

1/ IMF Country Report No. 04/404, (9/30/04).
2/ Sales of treasury bills for monetary policy purposes.
3/ 2003 includes the takeover of state oil company (SOLIMA) debt (FMG 350.4 billion) by the government.
4/ Consistent with the TMU, the program target for end-September and end-December reserve money will be adjusted for changes in the reserve requirement ratio.

Table 7. Madagascar: Consolidated Balance Sheet of Commercial Banks (DMBs), 2003-05
(In billions of Malagasy francs, unless otherwise indicated)

	2003	2004					2005				
	Dec.	Jun.	Sep.		Dec.		Mar.	Jun.	Sep.	Dec.	
			Prog. 1/	Act.	Prog. 1/	Proj.	Proj.	Proj.	Proj.	Proj. 1/	Rev. Proj.
Net foreign assets	1,055.3	1,704.8	1,607.6	1,713.0	1,606.2	1,730.2	1,934.1	1,934.1	1,980.7	1,882.3	2,058.4
Net domestic assets	4,897.5	5,242.5	5,329.5	5,420.5	5,397.7	5,421.2	5,825.1	6,001.3	6,314.9	6,032.2	6,466.0
Bank reserves	954.6	738.2	879.4	767.2	884.6	1,168.8	1,265.2	1,289.7	1,339.7	983.3	1,371.5
Liabilities to BCM	-17.2	-13.4	-15.5	342.3	-15.5	-12.7	-12.7	-12.7	-12.7	-15.5	-12.7
Credit to government (net)	1,381.0	1,390.1	892.2	1,024.2	792.2	824.0	824.0	824.0	824.0	696.0	824.0
Purchase of liquidity paper 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net credit to government (budget)	1,381.0	1,390.1	892.2	1,024.2	792.2	824.0	824.0	824.0	824.0	696.0	824.0
Other claims on public sector	410.5	429.9	424.8	450.5	424.8	446.7	446.7	446.7	446.7	424.8	446.7
Claims on public enterprises	28.5	48.9	48.1	46.5	48.1	50.5	50.5	50.5	50.5	48.1	50.5
Credit to private sector	2,974.5	3,503.8	3,641.4	3,710.7	3,634.3	3,825.5	4,135.5	4,287.2	4,550.8	4,441.0	4,670.1
Other items (net; assets +)	-834.4	-855.1	-540.8	-920.8	-370.8	-881.7	-884.2	-884.2	-884.2	-545.6	-884.2
Deposits	5,775.6	6,784.0	6,781.4	7,003.7	6,841.4	7,019.2	7,627.1	7,803.2	8,163.4	7,751.9	8,392.3
Deposits in local currency 3/	4,688.7	5,049.0	5,203.0	5,215.5	5,262.9	5,308.3	5,714.6	5,890.7	6,251.0	5,902.1	6,479.8
Deposits in foreign currency (time deposits)	1,086.9	1,735.1	1,578.4	1,788.1	1,578.4	1,710.9	1,912.5	1,912.5	1,912.5	1,849.8	1,912.5
(in millions of SDRs)	120.4	114.4	114.9	117.4	114.9	118.2	118.2	118.2	118.2	114.9	118.2
Short-term bonds (liabilities)	177.2	163.2	155.7	129.8	162.6	132.2	132.2	132.2	132.2	162.6	132.2

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

1/ IMF Country Report No. 04/404, (9/30/04).
2/ Sales of treasury bills for monetary policy purposes.
3/ Includes *Comptes de Cheques Postaux and Caisse d'Epargne de Madagascar* deposit accounts.

Table 8. Madagascar: Balance of Payments, 2003-09
(In millions of SDRs, unless otherwise indicated)

	2003	2004		2005	2006	2007	2008	2009
		Prog. 1/	Proj.	Revised Projections				
Current account	-191.6	-277.6	-248.9	-262.0	-224.4	-212.0	-198.8	-189.9
Goods and services	-350.9	-458.7	-439.5	-426.1	-395.0	-386.0	-374.5	-369.6
Trade balance	-135.7	-284.2	-265.6	-272.0	-252.3	-236.7	-224.7	-218.9
Exports	672.8	596.4	621.2	674.0	719.5	780.2	842.7	905.8
Imports	-808.5	-880.6	-886.8	-946.0	-971.8	-1,016.9	-1,067.4	-1,125
Net services (net)	-215.2	-174.5	-174.0	-154.1	-142.8	-149.3	-149.9	-150.7
Services, receipts	229.3	256.7	259.1	285.4	319.9	337.1	361.8	388.7
Services, payments	-444.5	-431.2	-433.1	-439.5	-462.7	-486.4	-511.7	-539.4
Income (net)	-57.0	-48.6	-54.9	-58.0	-56.6	-58.5	-60.6	-62.7
Receipts	11.7	22.0	10.0	10.3	10.9	11.5	11.9	12.2
Payments	-68.7	-70.6	-64.9	-68.3	-67.5	-70.0	-72.5	-74.9
Of which : government interest [2]	-40.5	-40.9	-39.1	-41.3	-41.0	-41.8	-42.4	-42.9
Current transfers	216.4	229.7	245.5	222.1	227.2	232.5	236.4	242.4
Government	102.0	119.7	110.8	84.7	85.6	86.7	87.0	90.0
Budget aid	91.6	109.3	97.1	68.7	75.6	76.7	77.0	80.0
HIPC relief [3]	22.2	20.3	20.0	22.2	26.9	25.8	23.8	24.6
Grants	69.5	89.0	77.2	46.5	48.8	50.9	53.2	55.4
Other (net) [4]	10.4	10.4	13.7	16.0	10.0	10.0	10.0	10.0
Private	114.4	110.0	134.7	137.4	141.5	145.8	149.4	152.4
Capital and financial account	165.3	250.4	218.3	243.7	271.1	276.8	254.6	255.9
Capital account (government project grants	63.8	124.5	93.7	121.7	128.1	134.5	141.3	148.1
Financial account	28.9	125.9	124.6	122.0	143.0	142.3	113.3	107.8
Direct investment	9.1	30.0	30.0	48.1	52.4	56.6	61.3	66.2
Of which : privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	19.8	95.9	94.6	73.9	90.6	85.6	52.0	41.7
Government	47.6	105.6	107.0	92.6	110.9	105.7	73.7	68.2
Drawing	121.0	173.6	173.4	155.2	171.0	160.0	132.2	130.2
Project drawings	83.5	122.9	123.2	116.5	131.0	120.0	102.2	99.2
Budgetary support	37.5	50.7	50.2	38.7	40.0	40.0	30.0	30.0
Non-government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Amortization [2]	-73.4	-68.0	-66.4	-62.6	-60.1	-54.3	-58.5	-62.0
Private sector amortization	-7.0	-9.7	-9.7	-10.8	-20.2	-20.1	-21.7	-26.6
Banks, net	-20.8	0.0	-2.7	-8.0	0.0	0.0	0.0	0.0
Other (incl. errors and omissions) [5]	72.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-26.2	-27.2	-30.6	-18.3	46.7	64.8	55.8	66.1

Table 8. Madagascar: Balance of Payments, 2003-09 (concluded)
(In millions of SDRs, unless otherwise indicated)

	2003	2004		2005	2006	2007	2008	2009
		Prog. 1/	Proj.	Revised Projections				
Financing	26.2	27.2	30.6	18.3	-46.7	-64.8	-55.8	-66.1
Net foreign assets (increase -)	-12.1	-13.4	-11.5	-14.4	-70.2	-78.0	-69.9	-80.8
Use of Fund credit (net)	5.9	29.5	29.5	2.3	-17.8	-18.4	-17.8	-22.4
Disbursements	11.3	34.9	34.9	11.3	0.0	0.0	0.0	0.0
Repayments	-5.4	-5.4	-5.4	-9.1	-17.8	-18.4	-17.8	-22.4
Other assets, net (increase -)	-18.0	-42.9	-41.0	-16.7	-52.5	-59.7	-52.0	-58.4
Debt relief and cancellation 6/	47.8	40.6	42.1	32.7	23.6	13.2	14.1	14.7
Memorandum items:								
Grants (in percent of GDP)	4.2	8.1	7.0	6.4	6.1	5.9	5.6	5.4
Loans (in percent of GDP)	1.2	3.5	3.6	2.9	3.2	2.8	1.8	1.5
Direct investment (in percent of GDP)	0.2	1.0	1.0	1.5	1.5	1.5	1.5	1.5
Current account (in percent of GDP)								
Excluding net official transfers	-7.5	-13.2	-12.2	-10.8	-8.9	-7.9	-7.0	-6.3
Including net official transfers	-4.9	-9.2	-8.5	-8.2	-6.4	-5.6	-4.9	-4.3
Gross official reserves	284.6	327.5	325.6	342.2	394.7	454.3	506.4	564.8
(in months of imports of goods and nonfactor service	2.7	3.0	3.0	3.0	3.3	3.6	3.8	4.1
Exchange rates								
Malagasy francs/SDR (period average)	8,646.0	...	13,860.4	...	...	...	...	...
Malagasy francs/U.S. dollar (period average)	6,203.4	...	9,354.1	...	...	...	...	...

Sources: Central Bank of Madagascar, Ministry of Finance, IMF Finance Dept., and Fund staff estimates and projections.

[1] IMF Country Report No. 04/404, (9/30/04).

[2] Interest and amortization payments are based on the HIPC completion point document (www.imf.org) and authorities' estimates.

[3] HIPC relief provided by multilateral creditors including the African Development Bank Group (AfDB), IDA, and the IMF.

[4] Other official grants less payments due to scholarships and contributions to international organizations.

[5] Includes commercial credits received or granted.

[6] HIPC bilateral debt relief.

Table 9. Madagascar: Sources and Uses of Resources, 2003-09

	2003	2004		2005	2006	2007	2008	2009
	Est.	Prog. 1/	Proj.	Projections				
	(In billions of Malagasy francs)							
GDP	33,893.2	39,445.5	40,778.4	49,712.3	55,807.6	62,240.5	69,414.9	77,197.8
Consumption	30,871.4	36,067.6	36,936.3	43,920.1	48,320.5	53,633.1	59,661.5	65,989.6
Public	3,108.0	3,374.7	3,741.9	4,031.3	4,753.4	5,588.2	6,324.6	7,346.4
Private	27,763.4	32,692.9	33,194.4	39,888.8	43,567.1	48,044.9	53,336.9	58,643.2
Investment	6,064.5	9,367.2	9,934.4	12,394.0	13,800.1	14,969.8	16,114.9	17,676.2
Domestic investment	6,064.5	9,367.2	9,934.4	12,394.0	13,800.1	14,969.8	16,114.9	17,676.2
Government	2,657.4	4,553.2	3,830.0	5,434.3	6,266.0	6,629.6	6,882.8	7,408.8
Private	3,407.1	4,814.0	6,104.4	6,959.7	7,534.0	8,340.2	9,232.2	10,267.3
Of which: direct foreign investmen	78.9	391.7	415.8	745.7	837.1	933.6	1,041.2	1,158.0
Changes in stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Resource gap	-3,042.6	-5,989.2	-6,092.3	-6,601.8	-6,313.0	-6,362.4	-6,361.5	-6,467.9
Exports of goods and nonfactor services	7,821.4	11,137.7	12,201.6	14,864.2	16,611.2	18,417.1	20,458.1	22,656.3
Of which : exports of goods	5,833.0	7,786.0	8,610.1	10,443.0	11,498.8	12,860.8	14,312.6	15,853.5
Imports of goods and nonfactor services	10,864.0	17,126.9	18,293.9	21,466.0	22,924.2	24,779.5	26,819.6	29,124.2
Of which : imports of goods	7,010.0	11,496.8	12,291.1	14,657.0	15,530.3	16,762.5	18,128.7	19,684.0

Table 9. Madagascar: Sources and Uses of Resources, 2003-09 (concluded)

	2003	2004		2005	2006	2007	2008	2009
	Est.	Prog. 1/	Proj.	Projections				
percent of GDP)								
Consumption	91.1	91.4	90.6	88.3	86.6	86.2	85.9	85.5
Public	9.2	8.6	9.2	8.1	8.5	9.0	9.1	9.5
Private	81.9	82.9	81.4	80.2	78.1	77.2	76.8	76.0
Investment	17.9	23.7	24.4	24.9	24.7	24.1	23.2	22.9
Domestic investment	17.9	23.7	24.4	24.9	24.7	24.1	23.2	22.9
Government	7.8	11.5	9.4	10.9	11.2	10.7	9.9	9.6
Private	10.1	12.2	15.0	14.0	13.5	13.4	13.3	13.3
Of which: direct foreign investmen	0.2	1.0	1.0	1.5	1.5	1.5	1.5	1.5
Changes in stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Resource gap	-9.0	-15.2	-14.9	-13.3	-11.3	-10.2	-9.2	-8.4
Exports of goods and nonfactor services	23.1	28.2	29.9	29.9	29.8	29.6	29.5	29.3
Of which : exports of goods	17.2	19.7	21.1	21.0	20.6	20.7	20.6	20.5
Imports of goods and nonfactor services	32.1	43.4	44.9	43.2	41.1	39.8	38.6	37.7
Of which : imports of goods	20.7	29.1	30.1	29.5	27.8	26.9	26.1	25.5
Gross domestic savings	8.9	8.6	9.4	11.7	13.4	13.8	14.1	14.5
Government	1.1	3.0	2.6	3.9	3.9	3.9	4.2	4.2
Nongovernment	7.8	5.6	6.9	7.8	9.5	9.9	9.9	10.3
Current account								
Excluding grants	-7.5	-13.2	-12.2	-10.8	-8.9	-7.9	-7.0	-6.3
Including grants	-4.9	-9.2	-8.5	-8.2	-6.4	-5.6	-4.9	-4.3
Gross national savings	13.0	14.6	15.9	16.8	18.3	18.4	18.4	18.6
Government 2/	3.7	8.1	5.9	7.6	8.0	8.0	8.1	8.1
Nongovernment	9.3	6.4	10.0	9.2	10.3	10.5	10.2	10.5

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

1/ IMF Country Report No. 04/404, (9/30/04).

2/ Defined as overall fiscal balance (on commitment bases, after net cost of restructuring) plus public investment expenditure.

Table 10: Madagascar: Millennium Development Goals

	1990	1995	2001	2002	2015 Target
<u>Goal 1. Eradicate extreme poverty and hunger</u>					
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.					
1. Population below US$ 1 a day (percent)	...	...	49.1	...	
2. Poverty gap ratio at US$ 1 a day (percent)	...	...	18.3	...	
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	6.4	...	
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	40.9	34.1	...	33.1	20.5
5. Population below minimum level of dietary energy consumption (percent)	35.0	40.0	36.0	...	17.5
<u>Goal 2. Achieve universal primary education</u>					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	...	60.6	68.7	...	
7. Percentage of cohort reaching grade 5	21.5	39.7	33.6	...	
8. Youth literacy rate (percent age 15-24)	72.2	76.3	80.8	81.5	
<u>Goal 3. Promote gender equality and empower women</u>					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015					
9. Ratio of girls to boys in primary and secondary education (percent)	98.9	99.2	...	...	100.0
10. Ratio of young literate females to males (percent ages 15-24)	85.6	88.8	92.1	92.5	
11. Share of women employed in the nonagricultural sector (percent)	26.0	...	...	...	
12. Proportion of seats held by women in the national parliament (percent)	7.0	4.0	8.0	8.0	

Table 10: Madagascar: Millennium Development Goals (continues)

	1990	1995	2001	2002	2015 Target
Goal 4. Reduce child mortality					
Target 5: reduce by two-thirds between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	168.0	156.0	139.0	135.0	54.0
14. Infant mortality rate (per 1,000 live births)	103.0	95.0	86.0	84.0	
15. Immunization against measles (percent of children under 12-months)	47.0	55.0	55.0	61.0	
Goal 5. Improve maternal health					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	580.0	550.0	...	127.0
17. Proportion of births attended by skilled health personnel	57.0	47.3	46.2	...	
Goal 6. Combat HIV/AIDS, malaria and other diseases					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	0.2	...	
19. Contraceptive prevalence rate (percent of women ages 15-49)	16.7	19.4	...	16.9	
20. Number of children orphaned by HIV/AIDS	...	...	6,300	...	
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
21. Prevalence of death associated with malaria	...	...	...	...	
22. Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...	
23. Incidence of tuberculosis (per 100,000 people)	...	...	254.5	...	
24. Tuberculosis cases detected under DOTS (percent)	...	65.0	60.0	61.6	

Table 10: Madagascar: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2015 Target
Goal 7. Ensure environmental sustainability					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources					
25. Forest area (percent of total land area)	22.2	...	20.2	...	
26. Nationally protected areas (percent of total land area)	...	1.9	1.9	2.1	
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...	
28. CO2 emissions (metric tons per capita)	0.1	0.1	0.1	...	
29. Proportion of population using solid fuels					
Target 10: Halve by 2015 proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	44.0	...	47.0	...	72.0
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers					
31. Access to improved sanitation (percent of population)	36.0	...	42.0	...	
32. Access to secure tenure (percent of population)	...	...	...	...	
Goal 8. Develop a Global Partnership for Development 1/					
Target 16: Develop and implement strategies for productive work for youth.					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	
Female	...	...	...	...	
Male	...	...	...	...	
Target 17: Provide access to affordable essential drugs					
46. Proportion of population access with access to affordable essential drugs	...	...	...	...	
Target 18: Make available new technologies, especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	2.8	3.0	13.3	14.0	...
48. Personal computers (per 1,000 people)		1.5	2.6	4.4	...

Sources: World Bank; and Fund staff estimates.

1/ Targets 12-15 and indicators 33-44 are excluded because they can not be measured on a country specific basis. These are related to official development assistance, market access, and the HIPC initiative.

Antananarivo, February 3, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato,

Discussions for the sixth and final review of the arrangement under the Poverty Reduction and Growth Facility (PRGF), approved by the IMF Executive Board on March 1, 2001, were held in Antananarivo over December 6-20, 2004. Discussions focused on economic and financial developments in 2004, implementation of structural reforms, and economic perspectives and policies for 2005. All quantitative performance criteria at end-September, as well as the structural performance criterion and benchmarks at end-December 2004, were met, and understandings were reached on quarterly macroeconomic and fiscal targets for 2005.

Successive monetary-tightening measures and a prudent fiscal policy, as well as the introduction of the continuous interbank foreign exchange market, have led to the desired reduction in liquidity and to the stabilization of the foreign exchange market, and the criterion on the accumulation of net foreign assets at end-September was met. However, inflationary pressures remained strong in the second half of the year, with the CPI rising by 27 percent year-on-year at end-December 2004, and continue to be fueled by high prices for petroleum products and rice, which account for about 25 percent of the CPI basket. Excluding petroleum products and rice, CPI inflation has remained fairly stable over the last months. These developments have led to upward revisions in nominal GDP growth and in average inflation to 20.3 percent and 13.8 percent, respectively, for the year as a whole.

Nominal tax revenue at end-September 2004 was higher than programmed, thus allowing the corresponding performance criterion to be met. The tax revenue target for the year as a whole has been revised upward by FMG 65 billion on account of the good expected performance of customs revenue. However, in view of the low revenue elasticity with respect to GDP, this revision only partially compensates for the upward revision in nominal GDP growth, and the revenue-to-GDP target for the year as a whole is now expected to reach 11 percent of GDP, against an original target of 11.2 percent. The resolution approving the installation of the new ASYCUDA++ software at customs—a structural performance criterion under the program at end-December 2004—was issued by the Minister of Economy, Finance and Budget on December 29, 2004.

Budget execution at end-September was broadly on track. However, revised projections for end-December 2004 foresee a widening of the domestic balance of 0.2 percent of GDP, reflecting the difficulties encountered in budget execution during the fourth quarter. Problems stemming from the underbudgeting of certain expenditures discussed in the September 29, 2004, Memorandum of Economic and Financial Policies

(MEFP) worsened, and unanticipated budgetary needs led to expenditure overruns. These overruns reflect, in part, frequent recourse to emergency spending procedures. Overall, current primary expenditure was 0.6 percent of GDP higher than programmed; however, the impact of this increase on the domestic balance was mitigated by additional efforts on the revenue side and the downward revision of domestically financed investment expenditure. The impact of the widening of the fiscal deficit on bank financing was dampened by the rise in the contribution of the non-banking sector to the financing of budgetary operations and higher-than-anticipated privatization receipts. The government is firmly committed to implementing the measures identified in the September 2004 MEFP to strengthen expenditure control significantly, including through better control of the military wage bill, and to taking the required additional measures to prevent the resurgence of similar problems in the future. A table detailing these additional measures is attached (Appendix I, Attachment I).

Macroeconomic policy for 2005 will be geared toward limiting the second-round effects of the supply and exchange rate shocks that affected the Malagasy economy in 2004. In this context, the main economic policy objectives will be to (i) achieve real GDP growth of 6.4 percent, (ii) limit inflation to 5.5 percent on a year-on-year basis, and to 13.9 percent on average, and (iii) ensure a level of foreign exchange reserves equivalent to at least three months of imports by end-2005. To meet these objectives, the government intends to implement the policies described in the following paragraphs.

Fiscal policy will remain prudent in 2005, thus helping meet the inflation objective. The fiscal balance (on a commitment basis) should move to a small surplus (FMG 7 billion) in 2005, a 1.6 percent of GDP improvement from 2004, reflecting both a prudent expenditure policy, as laid out in the 2005 finance law, and the upward revision of the nominal revenue objective. The tax revenue-to-GDP ratio should reach 11.6 percent of GDP in 2005 (an improvement of 0.6 percentage points of GDP over end-2004), consistent with the objectives of the poverty reduction strategy. To ensure that this objective will be met, the 2 percentage point reduction in the VAT rate (from 20 to 18 percent) will not become effective until September 1, 2005, and additional measures aiming at, among other goals, strengthening ex post controls and intensifying the fight against fraud at customs, as well as improving cooperation between various fiscal administrations, will also be implemented. A table laying out these measures is also attached (Appendix I, Attachment II). The government will also start assessing measures that could increase the contribution of the mining sector to fiscal revenue, in consultation with its main development partners—in particular, the International Development Association (IDA). In the area of public expenditure management, the government will continue to implement the recommendations of the HIPC Assessment and Action Plan report, as well as the measures discussed in paragraph 4 above.

The objective of monetary policy is to contain inflation. The government is confident that it can meet its inflation objective for 2005 (5.5 percent at end-2005, on a year-on-year basis). Monetary growth (as measured by M3) is expected to grow by 19.2 percent in 2005, slightly lower than nominal GDP growth. To meet these objectives, the BCM will (i) further strengthen its ability to forecast and manage liquidity and foreign exchange cash flow;

(ii) broaden its instruments to mop up excess liquidity, including by increasing access to treasury bill auctions, which should widen the investor base; (iii) further improve coordination between the treasury and the BCM; and (iv) develop the money market. Furthermore, banking supervision will be strengthened, in particular following the recommendations by the recent MFD technical assistance mission, with a view to preserving the soundness of the banking system.

On the external front, the government is cognizant of the challenges to the textile sector resulting from the termination of the MFA in early 2005 and of the third-party apparel provision of AGOA in early 2007. It will closely monitor the situation and will strive to improve Madagascar's overall competitiveness. It will also develop policies aimed at diversifying Madagascar's export base, including through an accelerated implementation of recommendations of the Diagnostic Trade Integration Framework. The government will also seek to identify specific measures designed to improve competitiveness and reduce regulatory burdens.

Regarding debt sustainability, the government is committed to maintaining the sustainable external debt position achieved as a result of reaching the completion point under the enhanced HIPC Initiative. To this end, it will borrow only on concessional terms following a careful analysis of Madagascar's debt burden and repayment capacity.

The new interbank foreign exchange market (MID) is functioning smoothly with marginal central bank intervention. The publication of the BCM-audited financial statements for 2003 and the issuance of operational guidelines for BCM interventions in the MID, which constituted structural benchmarks under the program at end-December 2004, have been met.

Privatization of the management of the public utilities company (Jirama) should become effective in the first half of 2005; however, the medium-term strategy for the development of the sector has not yet been finalized. The government also intends to make progress toward the privatization of the two major public insurance companies (Aro and Havana).

We are finalizing a time-bound capacity-building plan for several government institutions, including in the area of public debt, fiscal, and monetary management, as well as interventions in the interbank foreign exchange market. The government intends to approach its main development partners to discuss possible support to the plan's implementation.

Sincerely yours,

/s/	/s/
Benjamin Radavidson Minister of Economy, Finance, and the Budget Antananarivo, Madagascar	Gaston Ravelojaona Governor Central Bank of Madagascar Antananarivo, Madagascar

List of Measures to Strengthen Budget Execution and Control

- Prepare terms of reference and launch the recruitment procedure for a technical assistant in the area of budget execution.
- Abolish the procedure of "spending by requisition" in the 2005 note on budget execution (*circulaire d'exécution budgétaire*).
- Establish a system strictly limiting the possibility of recourse to emergency spending procedures in the 2005 budget execution note by (i) limiting possible recourse to the emergency spending procedure to a list of pre-identified ministries and institutions; (ii) setting a system of rolling *caisses d'avances* for eligible ministries and institutions; and (iii) strictly applying the principle of non-replenishment of the *caisses d'avances* in case expenditures are not regularized within the regulatory deadline.
- Issue a communication to the Council of Government on the new procedures for emergency spending.
- Prepare terms of reference for the audit by the General State Inspectorate (IGE) of expenditure incurred through the requisition procedure in 2004.
- Ensure that the IGE transmits its audit report to the Budgetary and Financial Discipline Council.
- Accelerate the setting up of the General Finance Inspectorate (IGF) to make it operational during the first semester of 2005.
- Transfer oversight responsibility for the military wage bill to the Ministry of Economy, Finance and Budget as of January 1, 2005.

LIST OF ADDITIONAL MEASURES TO STRENGTHEN TAX REVENUE COLLECTION

- Intensify tax verifications through the systematic use of data generated by other financial administrations, in particular customs, the Treasury, and the public procurement office (Tax Directorate).

- Intensify verification and strengthen collection procedures on excise tax goods (Tax Directorate).

- Strengthen taxation of real estate transactions (Tax Directorate).

- Increase the rate of the Petroleum Product Tax (TPP) to offset the revenue loss stemming from the 2 point reduction of the Value Added Tax on Petroleum Products (TVAPP), starting September 1, 2005 (Customs Directorate).

- Strengthen the risk-management system at customs through improved cooperation of the pre-shipment inspection agency (systematic use of Valuenet and Profiler databases, and systematic cross -checking of customs declarations with inspection reports) (Customs Directorate).

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets
for 2004 under the PRGF Arrangement
(In billions of Malagasy francs, unless otherwise indicated 1/

	2004										
	March Performance Criteria			June Indicative			September Performance Criteria			Is the PC or target met?	December Indicative
	Program 2/	Adjusted	Actual	Program 2/	Adjusted	Actual	Revised 3/	Adjusted	Actual		Program 3/
I. Quantitative performance criteria											
(a) Ceiling on external arrears (in millions of SDRs) 4/	0.0		0.0	0.0		0.0	0.0		0.0	Yes	0.0
(b) Floor on net foreign assets (NFA) of the central bank 4/ 5/ 6/ 7/	221.8	215.1	166.9	80.9	103.0	-139.9	1,132.1	1,197.8	1,320.6	Yes	918.7
(c) Ceiling on net domestic assets (NDA) of the central bank 6/ 7/ 8/	23.5	30.2	-176.1	249.0	226.9	13.7	-463.8	-529.6	-787.0	Yes	-219.6
(d) Ceiling on domestic financing of the government 8/ 9/ 10/	-83.3	-76.6	-2.3	108.7	94.2	68.7	-550.3	-508.6	-610.7	Yes	-659.5
(e) Ceiling on contracting or guaranteeing of external debt on nonconcessional terms 11/	0.0		0.0	0.0		0.0	0.0		0.0	Yes	0.0
(f) Floor on tax revenue	1,010.5		997.6	2,164.3		2,125.6	3,191.3		3,222.9	Yes	4,417.9
(g) Ceiling on accumulation of domestic arrears	0.0		7.0	0.0		0.0	0.0		0.0	Yes	0.0
II. Indicative targets											
(h) Ceiling on reserve money	236.3		-92.9	320.9		-137.5	-79.5	124.9	-31.9	Yes	-49.5
(i) Ceiling on broad money (including foreign currency deposits) (M3)	617.6		164.1	838.1		356.9	980.1		1,160.8	No	1,071.7
(j) Floor on arrears payments	140.8		230.0	175.3		271.6	287.0		216.9	No	347.3
III. Memorandum item:											
(k) Budget support grants and loans (in millions of SDRs)	18.0		18.0	30.1		32.1	118.7		121.1		139.7
(l) External cash debt service (in millions of SDRs)	8.2		8.9	24.9		25.2	29.3		34.75		42.4
(m) External privatization proceeds	0.0		0.0	0.0		7.5	7.5		115.0		7.5
(n) Total privatization proceeds	2.2		10.1	23.4		127.1	127.1		128.9		136.1
(o) External privatization related costs	0.0		0.0	0.0		0.0	0.0		0.0		0.0

Sources: Malagasy authorities; and Fund staff estimates and projections.
1/ Cumulative change since end-December.
2/ IMF Country Report No./04/91.
3/ IMF Country Report No./04/404.
4/ Excludes all debt service outstanding that is subject to rescheduling. During the program period, the government will not accumulate any new arrears.
5/ Defined as gross reserves minus all foreign liabilities of the BCM, both long and short term, including use of Fund credit, evaluated at the program exchange rate.
6/ Adjusted for any excess disbursements of external budget support (grants and loans; in millions of SDRs) relative to the cumulative amounts indicated in III.
7/ Adjusted for any deviation from programmed amounts of privatization receipts from abroad, net of privatization-related outlays.
8/ Adjusted for the impact of exchange rate changes.
9/ Defined as bank and nonbank financing plus treasury correspondent account (net), privatization receipts, and net accumulation of arrears.
10/ Adjusted downward to fully reflect any excess disbursements of external budget support (grants and loans, in millions of SDRs converted at the program exchange rate) relative to the cumulative amounts indicated in III, and upward up to an agreed capping amount in the event of a shortfall of external budget support, as defined above.
11/ Excluding normal import-related credits.

Table 2. Structural Performance Criteria and Benchmarks
for the Sixth Review Under the PRGF-Supported Program

	Timing	Status
Structural Performance Criteria		
No tax and tariff exemptions will be granted beyond those specified in the 2004 budget law	Continuous	Met
Issue a resolution approving the newly installed ASYCUDA ++ software and setting a date for the use of the software by customs	End-December 20004	Met
Structural Benchmarks		
Issue a resolution by the Board of Executive Directors of the Central bank (BCM) establishing the operational guidelines for BCM intervention in the interbank foreign exchange market (MID)	End-December 20004	Met
Publish the BCM’s complete audited financial statements for 2003	End-December 20004	Met

Madagascar: Relations with the Fund
(As of December 31, 2004)

I. Membership Status: Joined 9/25/63; Article VIII

II. General Resources Account:	**SDR Millions**	**% Quota**
Quota	122.20	100.00
Fund holdings of currency	122.17	99.98
Reserve position in Fund	0.03	0.02

III. SDR Department:	**SDR Millions**	**% Allocation**
Net cumulative allocation	19.27	100.00
Holdings	0.12	0.61

IV. Outstanding Purchases and Loans:	**SDR Millions**	**% Quota**
Poverty Reduction and Growth Facility (PRGF) arrangements	145.42	119.00

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR millions)	Amount Drawn (SDR millions)
PRGF	03/01/01	03/01/05	91.65	80.30
ESAF/PRGF	11/27/96	11/30/00	81.36	78.68
ESAF	05/15/89	05/14/92	76.90	51.27

VI. Projected Payments to Fund (without HIPC Initiative Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	8.14	16.87	17.56	17.12	21.75
Charges/Interest	1.13	1.07	0.98	0.89	0.80
Total	9.27	17.94	18.54	18.01	22.54

Projected Payments to Fund (with Board-approved HIPC Initiative Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	6.96	12.23	14.81	17.12	21.75
Charges/interest	1.13	1.07	0.97	0.89	0.80
Total	8.09	13.30	15.79	18.01	22.54

VII. Implementation of HIPC Initiative:

Commitment of HIPC Initiative assistance	Enhanced Framework
Decision point date	Dec. 2000
Assistance committed (NPV terms)	
Total assistance (US$ Million)[15]	835.75
Of which: Fund assistance (US$ million)	19.17
(SDR equivalent in millions)	14.73
Completion point date	Oct. 2004

Disbursement of IMF assistance (SDR million)	
Assistance disbursed to the member	14.73
Interim assistance	5.62
Completion point balance	9.11
Additional disbursement of interest income[16]	--
Total disbursements	14.73

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the Central Bank of Madagascar (BCM) is subject to a safeguards assessment with respect to the PRGF arrangement, which was approved on March 1, 2001. An off-site safeguards assessment of the BCM, which was completed on November 21, 2001, identified weaknesses and made appropriate recommendations, as reported in www.imf.org. These weaknesses are being addressed with the assistance of MFD, but key recommendations such as the timely publication of the audited financial statements and the adoption of International Financial Reporting Standards as the bank's accounting framework remain to be implemented.

[15] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point.

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

IX. Exchange System and Exchange Rate Arrangements:

After April 1982, when the peg to the French franc was discontinued, the exchange rate was managed with reference to a basket of ten currencies. However, by end-1991, the authorities ceased the practice of adjusting the exchange rate to offset inflation differentials with key trading partners. Since July, 2004, the Malagasy franc has been determined through a continuous interbank foreign exchange market system and on January 1, 2005, the Ariary (AR) replace the Malagasy franc as the country's official unit of account, at the rate of AR 1=FMG 5. The exchange rate in terms of the SDR at end-December 2004 was AR 2,896 = SDR 1.

Madagascar accepted the obligations under Article VIII, Sections 2(*a*), 3, and 4 on September 18, 1996 and maintains no restrictions on the making of payments and transfers for current international transactions.

X. Last Article IV Consultation:

Madagascar's consultation cycle is governed by the decision approved by the Executive Board on July 15, 2002. This decision stipulates that, subject to certain exceptions, an Article IV consultation with a member receiving financial assistance under a Fund arrangement is expected to be completed within 24 months of the conclusion of the previous Article IV consultation. The 2002 Article IV consultation staff report was discussed by the Executive Board on December 23, 2002.

XI. Technical Assistance:

Department	Dates	Purposes	Results of Missions
FAD	July-August 1994	Assess the decline in the country's tax effort and recommend measures to mobilize additional revenue.	Elimination of all ad hoc tax exemptions, beginning with the 1995 budget, recommended.
FAD	September 1995	Assess the need for reforming the value-added tax (VAT) and develop a strategy to improve tax and customs administration.	Broadening of the VAT base and the creation of a special office for the monitoring of transactions in the free export zone recommended.

Department	Dates	Purposes	Results of Missions
FAD	September 1996	FAD advisor to assist the authorities in implementing the recommendations of FAD September 1995 mission. Assignment extended to March 1998.	The large-taxpayer unit established. Implementation of VAT reform continued.
FAD	December 1997	Review existing tax incentives and prepare action plan to improve the performance of the tax and customs departments.	Program proposed to curtail exemptions and implement an exemption-monitoring scheme.
FAD	February 1998	Hold follow-up discussion on tax and tax administration reform program.	Schedule for the preparation and implementation of key measures established.
FAD	March 1998	Examine and assess budgetary expenditures, control, and management.	Comprehensive report prepared for the reform of budget planning, execution procedures, and control systems.
FAD	April 1998	Review important issues to be addressed in the area of customs administration.	Agenda for follow-up mission identified (July 1998).
FAD	June 1998	Conduct follow-up visit on expenditure control.	Action plan, based on the report of the FAD mission of March 1998, established.
FAD	May, September, and December 1998 and April, May, and June 1999	Hold follow-up discussions on tax and tax administration reform.	Assistance for the revision of the VAT law provided, and a VAT reimbursement system introduced for free export zone producers.

Department	Dates	Purposes	Results of Missions
FAD	July 1998	Identify measures to strengthen customs administration.	Report prepared on duty assessment and collection procedures, the coordination between the preshipment inspection company and the customs department, the computerization strategy, and organizational issues.
FAD	January 1999	Help implement earlier FAD recommendations on improving public expenditure management.	Aide-mémoire prepared on progress in harmonization of budget and treasury classifications, computerization of treasury offices, implementation of a cash management and financial plan, and implementation of a budget and accounting classification for the decentralized budget.
FAD	June 1999	Strengthen tax audit system of large-taxpayer unit.	Action program developed and agreed with the authorities.
FAD	February-March 2001	Examine and assess budgetary control and management.	Comprehensive report prepared for the reform of budget planning, execution procedures, and control systems.
FAD	January-February 2003	Examine and assess tax and customs administration.	Comprehensive action plan and report on establishment of an oversight committee prepared.
FAD	July-August 2003	Examine and assess tax policy and assist in tax policy design.	Comprehensive action plan and report on next steps prepared.
FAD	May-June 2004	HIPC Assessment and Action Plan (AAP).	Comprehensive action plan established.
MFD	August 1993–99	Assign a bank supervision advisor and assist in the adoption of an interbank foreign exchange market.	Supervisory agency strengthened.

Department	Dates	Purposes	Results of Missions
MFD	April-May 1994	Review the modalities for liberalizing the exchange regime and accompanying monetary and credit measures.	Interbank exchange market adopted in May 1994. Central bank base rate and reserve requirements increased.
MFD	May 1995	Review interbank foreign exchange market, develop indirect instruments of monetary management, and reduce banks' excess reserves.	Recommendations adopted during the second half of 1995.
MFD	October-November 1998	Assess the operation of the foreign exchange and treasury bill markets; introduce the euro quotation currency.	Recommendations for treasury bill market adopted in November 1998.
MFD	December 1998	Prepare the change to the euro as pivot currency.	Euro introduced as scheduled.
MFD	May-June 1999	Prepare for introduction of continuous-quotation foreign exchange market, including procedures manual and market rules.	Recommendations were implemented in 2004.
MFD	October-November 1999	Assess exchange regulations and compliance with the Basel Core Principles for effective banking supervision.	Recommendations on banking regulation to be adopted.
MFD	November-December 2002	Assess progress in the implementation of the Core Principles for effective banking supervision; and examine the early warning system for detecting bank failures.	Recommendations being implemented.
MFD	November 2002	Take an inventory of microfinance institutions and define a strategy for their supervision.	Recommendations being implemented.

Department	Dates	Purposes	Results of Missions
MFD	November 2002	Assess management of foreign reserves and propose concrete steps for its improvement.	Recommendations being implemented.
MFD	March 2003	Review central bank internal audit functions.	Awaiting final report.
MFD	March 2003	Review microfinance regulation.	Awaiting final report.
MFD	June 2003	Review currency reform.	Recommendations being implemented.
MFD	September 2004	Review operations of the newly installed interbank foreign exchange market.	The report is being finalized.
MFD	November 2004	Review and make recommendations for strengthening the early-warning system of commercial banks.	The report is being finalized.
STA	October 1995	Review money and banking statistics.	Recommendations for data improvements adopted.
STA	June 2001	Review balance of payments compilation system.	Recommendations for improvements accepted and being adopted.
STA	July-August 2001	Review money and banking statistics.	Recommendations for data improvements accepted and being adopted.
STA	February 2004	Multisector statistics mission.	Recommendations for data improvements accepted.

XII. Resident Representative:

Madagascar has had a Fund Resident Representative since September 1989.
Mr. Samir Jahjah took up the post of Resident Representative at end-September 2003.

Madagascar: Relations with the World Bank

(As of December 2004)

Partnership in Madagascar's Development Strategy

1. The Government's poverty reduction strategy (PRSP), was endorsed by the World Bank and IMF Boards in November 2003. The Strategy outlines a framework for the Government to redouble its efforts to implement a new generation of economic and social reforms. The Strategy was developed over three years, starting under the previous administration and continued by the new Government. The overarching goal of the PRSP is to cut the poverty rate by half in ten years, from 70 percent in 2003 to 35 percent in 2013. To reach this objective the Strategy, based on the principle of public private partnership, has three main axes (i) restoring rule of law and a well governed society; (ii) promoting economic growth with a large social base, and (iii) promoting systems for establishing human security and enlarging social protection. Fifteen policy areas and corresponding measures, proposed outputs and expected outcomes underpin these strategic axes. The main areas are to improve governance, create a business friendly environment for investment and accelerate private sector led growth and improve social service delivery to the benefit of its citizens. The Government prepared its First Annual PRSP Progress Report in July 2004.

2. A summary of IMF-World Bank collaboration in Madagascar is provided in Table 1. The IMF leads in supporting Madagascar's medium-term program for maintaining macroeconomic stability. In March 2001, the IMF approved a Poverty Reduction and Growth Facility (PRGF) which extends until March 2005. The goal of the PRGF is to support Madagascar's efforts to foster macroeconomic stability, promote accelerated growth, improve social services, and reduce poverty. It focuses on strong fiscal consolidation to lower public debt and structural reforms including: (i) monetary policy and financial sector reform; (ii) improvement in tax administration; (iii) restructuring/privatization of public enterprises; and (iv) trade reforms.

3. The World Bank leads the policy dialogue in structural and institutional reforms aimed at: (i) strengthening governance in the public sector; (ii) accelerating pro-poor economic growth and supporting foreign investment and private sector development; and (iii) ensuring human development and security, such as in health, education, nutrition and social protection.

Bank Group Strategy and lending operations

4. The World Bank's FY04-06 Country Assistance Strategy (CAS) for Madagascar is fully aligned to the Government's program, and refocuses the existing portfolio to better align itself to the PRSP objectives and to address the key constraints to broad based growth. In FY04, the Bank approved new projects in transport, environment and governance. An Integrated Growth Poles project for FY05 addressing infrastructure and private sector development and a watershed management project are in the pipeline. The CAS also reflects a gradual transition from investment to programmatic lending with annual Poverty Reduction Credits (PRSC) starting in FY05. The first Poverty Reduction Support Credit (PRSC) addressing governance, education and nutrition was approved in July 2004. A second PRSC is expected to follow in FY06. Recently completed and ongoing analytical work such as a Rural and Environment Sector Review, a Tourism Study, a Poverty Assessment, financial management and public procurement reviews. A

Public Expenditure Review, and a Development Policy Review provide the foundation for programmatic lending and policy dialogue.

5. The Bank's current portfolio consists of 17 projects with total commitments of around US$956 million, of which about US$504 million was disbursed as of December 27, 2004. Of these total current commitments, around 43 percent are in infrastructure, transport, energy and mining, about 34 percent in the social sectors, 16 percent in rural development and rural water, 4 percent in finance and private sector development, and 3 percent in targeted governance support.

IMF-World Bank Collaboration in Specific Areas

Areas where the Bank takes the lead

7. Areas in which the World Bank takes the lead are related to specific sector advice in the areas in which the Bank has active lending operations (especially in the social sectors, infrastructure, agriculture and environment) as well as through a number of analytical studies as described above. Together with the Government and other donors, the Bank is also involved in supporting aid coordination. This has included mobilizing US$2.3 billion over a period of four years for Madagascar's reconstruction and development program financing following the 2002 crisis, and mobilizing donor support for implementing the Government's PRSP and to the Education for All initiative.

Areas in which the IMF takes the lead

8. Areas where the Fund takes the lead role relate to policy advice and reforms with respect to (i) overall macroeconomic policies and targets; (ii) tax policy and administration; (iii) budgetary accounting; (iv) treasury procedures; (v) public sector wage policy; and (vi) monetary management and exchange rate policy (including the changeover from the Malagasy franc to the new currency, the Ariary). The Bank team actively participates in discussions between the Fund and the government in all these areas, however, especially with respect to the setting of overall macroeconomic targets as well as tax policy.

Areas of Joint Responsibility

9. IMF and World Bank staff maintain a close working relationship, especially with respect to (i) monitoring the Poverty Reduction Strategy Paper; (ii) reforms set out at the decision point of the Highly Indebted Poor Countries Initiative, which culminated in Madagascar reaching completion point in October 2004; (iii) analyses and reforms in public financial management; (iv) other governance reforms, including customs; (v) support of the privatization program; and (vi) participation in the integrated framework trade initiative. Joint policy advice between the Bank and the Fund is given on (i) budgetary procedures, including expenditure execution; (ii) the functioning of internal and external budget control institutions; and (iii) monitoring and continuation of the privatization program. Table 1 includes a short description of each of the areas and specific support from the two institutions with respect to policy advice.

TABLE 1: BANK/FUND COLLABORATION

Area	***Description***	***Specialized Advice/ Reforms Supported by Fund***	***Specialized Advice/ Reforms Supported by Bank***
Completion of full PRSP	Together with multi- and bilateral donors, Bank/Fund provided continuous technical assistance toward completion of full PRSP in 2003	Macroeconomic framework: growth, revenue, expenditure, trade projections	Poverty analysis; rural poverty study; education and health sector work
HIPC completion point reforms	Regular joint Bank/Fund supervision missions; joint preparation of HIPC 'Tracking Poverty-Related Spending' assessment and action plan	Reforms linked to budgetary accounting and controls	Reforms in education, health, rural transport sector
Public financial management	Joint Bank/Fund missions analyzing fiscal management	Tax analysis and reform, strengthening control organs; expenditure management	Budget formulation, expenditure monitoring and analysis, especially in sectors important for poverty reduction; procurement, strengthening internal and external controls.
Other governance reforms	New Government has embarked on large governance reform agenda; Bank/Fund staff work closely with UNDP/EU/AfDB staffs on assisting development of implementation plans	Customs	Anti-corruption agenda, decentralization, judicial sector reform
Privatization Program	Close joint monitoring of Government's large privatization program comprising four major and several dozen smaller public enterprises	All sectors, especially monitoring of privatization receipts of large enterprises (petroleum, telecom)	All sectors.
Integrated Framework/ Trade Analytical Work	Integrated Framework paper FY04	Macro projections for IF framework paper	Sectoral analysis for IF framework paper

10. Questions may be referred to Mr. Willem van Eeghen (473-2399), Country Program Coordinator for Madagascar at the World Bank.

Madagascar: Statistical Issues

1. Madagascar's database remains weak, particularly the real sector, government finances, the balance of payments, and social indicators. The authorities are aware of these deficiencies and are working, with technical assistance from the international community, including the Fund, to strengthen their statistical system. Madagascar is a participant in the General Data Dissemination System (GDDS), and its metadata have been posted on the DSBB as of May 20, 2004). STA balance of payments and monetary and financial statistics technical assistance missions visited Antananarivo in June and July 2001, respectively. Following a request by the authorities, a multisector statistics mission was fielded during February 12-25, 2004.

Real sector

2. Production of a complete set of national accounts (benchmark data) is infrequent and depends largely on the availability of source data, whose collection is irregular. The last set of such accounts was produced for 1995 and 1984. For the intermediate years, only estimates of GDP at current and constant (1984) prices are produced broken down by activity and expenditure categories. These estimates, which still broadly follow the *1968 SNA*, are revised frequently and are considered unreliable, owing to the scarcity of source data or their inadequate use, and to methodological shortcomings. In particular, the estimates of the agricultural activities are weak because of the unavailability of suitable information about the size and the evolution of this sector. Moreover, service activities are not properly covered and little information is available on the magnitude of the informal sector. The INSTAT envisages passage to the *1993 SNA* by implementing the ERE/TES software designed for compilation of national accounts and by changing the base year from 1984 to 2001. Significantly, in January 2002, the publication of a quarterly index of industrial production by export processing zone (EPZ) enterprises was introduced, with external technical and financial assistance. There are plans to begin developing a quarterly industrial production index (covering non-EPZ enterprises), should discussions concerning United Nations Development Program (UNDP) financial assistance be completed early.

3. A revamped consumer price index (CPI), with weights based on the 1993 household survey and covering four principal cities, was introduced in July 2000. The CPI is generally reported to Fund staff on a timely basis. Data on producer prices and nationwide employment are not available. Various considerations drive the ongoing work on the wholesale price index (WPI) renewal—the key issue being the relative importance of the commercial activities in the Malagasy economy. However, the utility of such an indicator is reduced due to the limited coverage of manufacturing products.

Government finance

4. The latest government finance statistics (GFS) data reported to STA for publication in the *GFS Yearbook* are for 2002 and cover the consolidated central government. However, many classification problems remain (requiring extensive use of adjustment entries to current expenditure), and detailed information is missing in the time series since 1996 for budgetary and nonbudgetary breakdowns and for central government debt. Madagascar does not report subannual data for publication in *International Finance Statistics.*

Balance of payments

5. Since 1984, the Central Bank of Madagascar (BCM) has been in charge of compiling and disseminating balance of payments statistics, and in 1997 it implemented the fifth edition of the *Balance of Payments Manual* (*BPM5)*. However, the current compilation system is flawed in many respects: the external trade data are derived from customs data, which suffer from inadequate coverage and deficient recording procedures. Moreover, significant smuggling activities, particularly related to the in the mining sector, further reduce the reliability of recorded trade data. Because the customs processing system has experienced numerous technical disruptions since 1998, the external trade data have limited serviceability and require many manual corrections. The current implementation of the ASYCUDA (automated system for customs data, Version 2.7) was largely completed by mid-2002, with the system installed in most customs offices. There are plans to further upgrade the customs processing system to ASYCUDA ++.

6. The 2004 multisector technical assistance mission reviewed the progress made in the transition to *BPM5* and found that the authorities had implemented the surveys to direct investment enterprises, using an upgraded international transactions reporting system (ITRS), although the results have yet to be incorporated in the balance of payments. The mission noted that the compilation system is still hampered by several recurring issues: excessive processing lags due to partial automation of customs reports, inadequate coverage, for example, for transactions and debt of the private sector, NGOs, foreign embassies in Madagascar, and transaction misclassification, e.g. debt relief obtained from multilateral financial institutions is recorded in current transfers instead of in capital transfers.

7. In addition, the export processing zones (EPZ) that process goods and reexport to a third economy are not properly identified within other business services (merchanting and other trade related services).

8. The present compilation system offers wide leeway to use available data. This is exemplified by the c.i.f./f.o.b. correction indicator of 15 percent, that is entirely attributed to freight, while ASYCUDA and port authorities can provide separate data for freight, insurance and other categories. Data for the service and income accounts rely excessively on the ITRS reports, whose accuracy is not routinely assessed against other data sources.

9. As noted by the technical assistance mission in June 2001, the INSTAT and the BCM adjust differently customs data using different techniques and publish two distinct series of trade statistics hampering the reliability of Madagascar's external transactions.

10. The compilation of external debt statistics is generally satisfactory, and the authorities are benefiting from technical assistance by the United Nations Conference on Trade and Development (UNCTAD) in installing the latest version of the Debt Management and Financial Analysis System (DMFAS). This system is not yet fully operational; some data entry remains to be completed, and certain DMFAS modules remain to be installed by UNCTAD technicians.

Monetary statistics

11. A STA monetary and financial statistics mission visited Antananarivo in July 2001. The 2001 mission found that the BCM implemented most of the recommendations of the 1995 monetary and financial statistics mission and further recommended (i) the widening of statistical coverage to microfinance institutions; (ii) the inclusion of the Savings Bank and Postal Administration in the "Other Depository Corporations" subsector; and (iii) the improvement in the timeliness of the BCM's balance sheet.

12. Since August 2001, the BCM is reporting monetary data monetary data to STA by e-mail for publication in *International Financial Statistics (IFS)*. After a brief interruption in data reporting due to the political crisis in 2002, regular data reporting resumed in July 2002. Data for the monetary authorities and deposit money banks through October 2004 have been published in the *IFS*.

13. The 2004 multisector mission assessed the status of the 2001 mission's recommendations and made additional recommendations to improve Madagascar's monetary statistics. It found that several recommendations are pending, such as (i) improvement of the staff and computer resources of the unit in charge of the monetary statistics compilation, (ii) electronic transmission of monthly call report forms by the commercial banks to the BCM, and (iii) expansion of broad money survey to include the microfinance institutions that issue liabilities meeting the national definition of broad money for Madagascar. Furthermore, the 2004 mission recommended improvements to the source data and the compilation of statistical methodology to compile Madagascar's monetary statistics in accordance with the Fund's methodology as described in the *Monetary and Financial Statistics Manuel (MFSM).*

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Madagascar: Core Statistical Indicators
(As of January 18, 2005)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/Debt Service
Date of latest observation	12/31/04	11/04	11/30/04	11/30/04	11/30/04	12/31/04	10/2004	Q2/03	Q4/03	9/2003	2003	9/2003
Date received	01/05/05	01/05/05	01/05/05	01/05/05	01/05/05	01/05/05	01/05/05	10/15/03	7/02/04	11/15/03	3/22/04	10/15/03
Frequency of data	M	M	M	M	M	M	M	Q	Q	M	A	A
Frequency of reporting	M	M	M	M	M	M	M	Q	Q	M	V	A
Source of update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting	M	M	M	M	M	M	M	M	M	M	V	V
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C

Notes: Frequency of data: D=daily; M=monthly; Q=Quarterly; A=annual.
Frequency of reporting: W=weekly; M=monthly; Q=quarterly; A=annually; V=irregularly in conjunction with staff visits.
Source of update: A=direct reporting by the Central Bank of Madagascar, Ministry of Finance and Economics, or other official agency.
Mode of reporting: M=mail (including e-mail); V=staff visits.
Confidentiality: C=unrestricted use.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
February 18, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth and Final Review Under Madagascar's PRGF Arrangement and Approves US$17.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Madagascar's performance under an SDR 91.7 million (about US$138.9 million) Poverty Reduction and Growth Facility (PRGF) arrangement. This opens the way for a release of a further SDR 11.3 million (about US$17.2 million).

Madagascar's three-year arrangement was approved on March 1, 2001 for an initial amount of SDR 79.43 million (about US $120.4 million) (see Press Release No. 01/7) and was extended on December 23, 2002 (see News Brief No. 02/133) until November 30, 2004. On March 17, 2004 the Board further extended the PRGF arrangement until March 1, 2005. and augmented it by SDR 12.22 million (about US$18.5 million) (see Press Release No. 04/53).

Following the Executive Board's discussion of Madagascar, Ms. Anne O. Krueger, First Deputy Managing Director and Acting Chair, stated:

“Madagascar’s performance under the PRGF-supported program in 2004 has been broadly successful. Notwithstanding the difficult economic environment in the first half of the year, growth has remained robust, the exchange rate has been stabilized, and fiscal discipline has been broadly maintained. Key objectives for the period ahead include maintaining strong economic growth while significantly reducing inflation and diversifying the export base. This will require tighter monetary and fiscal policies, and accelerated implementation of structural reforms.

“A further strengthening of fiscal policy in 2005 will need to be based on additional steps to raise domestic revenue. Expenditure increases will be mainly directed toward priority sectors for poverty reduction and attainment of the Millennium Development Goals. At the same time, ongoing reforms of the public expenditure management system will need to be accelerated in order to improve the quality and efficiency of public spending.

“Monetary policy will be geared toward achieving the inflation objective. The further steps planned to strengthen monetary policy implementation and develop monetary policy instruments are welcome.

"Preserving overall competitiveness and diversifying the export base will be key for helping to secure broad-based and sustainable growth, particularly in light of the challenges that the economy may face with the expiry of the Multifibre Agreement and the third-party apparel provision of the African Growth Opportunity Act (AGOA III). Accelerated structural reforms should aim at lowering the costs of production, further improving the business climate, and raising the productivity of the export sector.

"Limited capacity continues to jeopardize program implementation. The time-bound action plan for capacity building in the areas of public debt and fiscal and monetary management should therefore be finalized quickly, with well-coordinated donor support.

"Attainment of the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in October 2004 has substantially reduced Madagascar's external debt. Preserving debt sustainability in the face of Madagascar's vulnerability to shocks will require continued pursuit of a prudent borrowing policy.

"The authorities' indication of interest in pursuing their relationship with the Fund beyond the current PRGF arrangement is welcome," Ms. Krueger said.

The PRGF is the IMF's concessional facility for low income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year period on principal payments.

Statement by Damian Ondo Mañe, Executive Director for Republic of Madagascar
February 18, 2005

Madagascar's economic performance under the program has continued to be strong. Despite a number of shocks, including 2 cyclones that hit the island in the early part of this year, and rising oil and rice prices, the authorities' determined implementation of their economic program has enabled them to meet all the quantitative performance criteria set for end-September, as well as the structural performance criterion and benchmarks set for end-December 2004. As I noted during the last Board meeting on Madagascar, the broad improvement in economic and financial performance over the program period, despite adverse exogenous shocks, can be attributed to the strong ownership of the program by the authorities, their commitment to the reform process, and the strong support of the international community for their efforts.

Recent Developments and Performance Under the Program

The economy is estimated to have grown by 5.3 percent in real terms, in 2004, indicating the increased resiliency of the economy to shocks, as a result of the reforms undertaken in the past years. Inflation was higher than programmed. As I explained in my last statement (BUFF/ED/04/179, 10/15/04), it was due to a number of factors, including, rising oil and rice prices, (which constitute 25 percent of the CPI basket), the impact of the cyclones on agricultural output, and the large depreciation of the Malagasy franc. In the face of strong inflationary pressures, the authorities have tightened monetary and credit policies.

In the fiscal sector, the deficit for 2004 has remained broadly within the program target. On the revenue side, reflecting the strong measures taken at customs, tax revenue is above target. This improved performance at customs is the result of the strong reform measures undertaken earlier. These included the rotation of more than 30 percent customs agents in the past six months, intensification of ex post controls and a strengthening of the fight against fraud, among others. Table 2 in the staff report shows that both tax revenue and total revenue for 2004 (in Malagasy francs) are above program targets, although as a percentage of GDP, the objective of 11.2 percent was not achieved, due to the upward revision of nominal GDP.

On the expenditure side, during the last quarter, expenditures were higher than had been projected. Underbudgetting of certain expenditures and other outlays, under emergency spending procedures, were the cause of the larger than budgeted expenditure. Nevertheless, total expenditure remained below program projections due to lower-than-anticipated foreign-financed expenditure. My authorities have taken steps to correct those weaknesses, and to strengthen expenditure control, including the control of the military wage bill.

Monetary policy has remained tight in the last quarter. However, the growth of broad money has remained strong, reflecting in part, demand from the private sector as a result of the pickup in economic activity in several sectors, and that of the privately owned oil companies following the liberalization of the sector. The authorities are monitoring carefully developments on the inflation front and the exchange rate market, and will take additional measures if needed.

In the structural area, the authorities have continued their reform efforts. The new anti-corruption bureau has started operations, and coordination with other agencies have been strengthened. As regards the sugar sector, contracts were signed with two private operators to manage the sugar company, SIRAMA. However, disagreements over staffing issues with one of the companies could not be resolved, and the government cancelled the contract with that company and awarded it to the other company. The authorities expect the privatization process to strengthen. As regards the utility company, JIRAMA, a private management company has been selected and has started operation. However, work is still ongoing on the development of the medium term strategy for that sector.

Policies for 2005

Although the present program expires next month, my Malagasy authorities would like to continue their close relationship with the Fund, in the context of a successor program. In the meantime, they have agreed with the staff on broad economic policies and objectives for 2005 that are consistent with the PRSP and the medium term objectives. Macroeconomic and structural policies will continue to be geared at fostering broad-based and sustained growth, with the deceleration of inflation to be an important objective in 2005.

Reflecting the significant transformation that the economy has undergone in the recent past towards a market economy, the investment made, in particular, in the agricultural and tourism sectors, as well as the strong construction activities, real GDP is projected to reach 6.4 percent in 2005. End-of-period inflation is expected to be brought down to about 5.5 percent, by December 2005, on the basis of the tight fiscal and monetary policies being pursued, and the expected decline in rice prices, and more stable or declining oil prices.

Fiscal policy will aim at reducing the deficit as well as contributing to the efforts to reduce inflationary pressures. The authorities are putting in place the measures to strengthen budgetary execution and control which will help to prevent the slippages that occurred last year. They intend to strengthen these efforts with the recruitment of an international expert. On the revenue side, the authorities will take additional measures to raise revenue, and continue their efforts to strengthen tax and customs administrations. The authorities will also postpone their decision to reduce the VAT from 20 percent to 18 percent until September, and they are working closely with the World Bank to improve the taxation of the mining sector. On the basis of these efforts, the authorities expect tax revenue to increase to 11.6 percent of GDP in 2005, and the overall fiscal deficit (including grants) is to be reduced to 1.6 percent of GDP.

As noted above, the reduction of inflation will be an important objective of policies in 2005. In this context, the central bank will pursue a tight monetary policy, while ensuring that adequate credit goes to the private sector to support economic activity. This should also be helped by the projected decline in the government's financing needs from the banking system. The authorities will continue their efforts to improve the effectiveness of monetary policy with technical assistance from MFD, in particular in the development of stronger forecasting instruments to better manage liquidity and foreign exchange cash flow. It will also, among others, improve coordination between the treasury and the central bank, develop the money market, and strengthen banking supervision.

As regards the exchange rate, the measures taken in the middle of last year, following the sharp depreciation of the Malagasy franc, have helped to stabilize the exchange rate and the market is functioning smoothly. The central bank will continue to allow the exchange rate to be market determined, and will intervene only to dampen sharp swings in the exchange rate and to meet the central bank's objective of net foreign assets accumulation.

The external accounts position will remain difficult, although the authorities expect a small improvement in the current account balance for 2005. The uncertainties come from the weak vanilla price and the termination of the Multi Fiber Agreement (MFA), as well as the scheduled expiration of the third-party apparel provision of the AGOA in early 2007. For their part, the authorities will continue their efforts aimed at export diversification. The difficult external outlook will also impact the debt situation, and could increase the NPV of debt to exports. To meet the development needs, the authorities will continue to rely on external financing at concessional terms, and strengthen debt-management capacity. However, as noted by staff, my authorities hope that the pressure for loan financing could be eased provided Madagascar benefits from the grants from the U.S. Millennium Challenge Account.

On structural reforms, the authorities will continue with the privatization program and the reforms in the fiscal area. They will also implement measures to improve the competitiveness of the economy and diversify the export base. Recent developments have shown that there is a critical need to strengthen capacity in the area of economic policy formulation and implementation. In this regard, the authorities are preparing a time-bound capacity-building plan for several government institutions. Once the plan is finalized, the authorities intend to request assistance in the different areas from their development partners, including the Fund. My authorities view this assistance as critical to strengthen capacity and improve policy implementation.

In conclusion, my Malagasy authorities are broadly satisfied with performance under the PRGF arrangement, and the objectives achieved. Last October, Madagascar also reached the completion point under the HIPC Initiative, for which my authorities have asked me to express their thanks and appreciation to the Board. My Malagasy authorities would also like to express their deep appreciation to their development partners for their strong and continued assistance to Madagascar. My authorities fully recognize that, despite the progress made, important challenges remain, and the progress made has to be consolidated. They will pursue steadfastly their reform efforts, and are hopeful that the international community will continue their strong support for these efforts. They would also like to continue the close relationship with the Fund, in the context of a successor PRGF arrangement, after the expiration of the present one in March 2005. They look forward to an early Fund mission in Antananarivo for discussions on such a program.