January 2009
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Malawi: Request for a One-Year Exogenous Shocks Facility Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Malawi

In the context of the request for a one-year Exogenous Shocks Facility Arrangement for Malawi, the following documents have been released and are included in this package:

- The staff report for a Request for a One-Year Exogenous Shocks Facility Arrangement prepared by a staff team of the IMF, following discussions that ended on September 16, 2008, with the officials of Malawi on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 19, 2008. 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 December 3, 2008 discussion of the staff report that completed the review.

- A statement by the Executive Director for Malawi.

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

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

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

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INTERNATIONAL MONETARY FUND

MALAWI

Request for a One-Year Exogenous Shocks Facility Arrangement

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Capital Markets, Strategy, Policy, and Review, and Statistics Departments)

Approved by Robert Corker and Adnan Mazarei

November 19, 2008

Discussions: Discussions were held in Lilongwe September 4–16, 2008. The staff met with Minister of Finance Goodall Gondwe, Governor of the Reserve Bank of Malawi Victor Mbewe, other senior government officials, and donor and civil society representatives. The staff team comprised Andrew Berg (head), Nils Maehle, Haimanot Teferra (all AFR), Gösta Ljungman, (FAD), and Armine Khachatryan (SPR). The Fund's resident representative in Lilongwe, Maitland MacFarlan, assisted the mission.

IMF relations: A three-year PRGF arrangement (SDR 38.2 million, 55 percent of quota) was approved on August 5, 2005 (Country Report No. 05/285). On July 14, 2008, Malawi completed the sixth and final review under the PRGF arrangement. At that time the Board also approved a 15 percent augmentation of the arrangement. Malawi reached the completion point under the enhanced HIPC Initiative on August 31, 2006, qualifying for further debt relief under the Multilateral Debt Relief Initiative. Outstanding Fund credit through September 2008 was SDR 46.2 million (66.64 percent of quota).

Safeguards assessment: An update of the 2006 safeguards assessment is currently in progress and will be completed by December 15, 2008.

PRSP: The joint staff advisory note on the first annual progress report on the Malawi Growth and Development Strategy (MGDS) was presented to the Executive Board on September 16, 2008.

New ESF arrangement: The authorities are requesting a one-year ESF arrangement (SDR 52.05 million, 75 percent of quota) to help them adjust to the terms of trade shock caused by rapid increases in fuel and fertilizer prices in the first part of 2008.

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EXECUTIVE SUMMARY

Malawi has requested a one-year arrangement under the high-access component of the Exogenous Shocks Facility (ESF) to help it adjust to the large terms of trade shock it has suffered. Malawi's reserves are inadequate to cover essential imports for a prolonged period even after a substantial adjustment effort. ESF assistance would cover a portion of the balance of payments need and catalyze additional support from donors.

Malawi's macroeconomic performance is generally strong, but the economy is feeling the impact of higher import prices. Real GDP growth has been high and is expected to remain solid. Inflation, though rising in recent months, is still moderate and, with world oil prices declining, is expected to ease over the medium term.

Malawi has been among the sub-Saharan African countries hit hardest by worsening terms of trade. The full impact on the balance of payments has not yet been felt because reserves have been buttressed by the seasonal concentration of tobacco proceeds in April-September. Still, gross reserves at the end of September were only 1.1 month of imports. They are expected to decline sharply in the near term because of rising import costs due to long pricing lags in import oil contracts and the concentration of fertilizer imports in coming months.

The government's near-term program aims to increase the import coverage of official gross reserves while preserving growth and food security. Monetary policy is being tightened and targeted domestic borrowing in 2008/09 is 1.4 percent of GDP lower than in 2007/08. The government is strengthening budget control to ensure fiscal discipline in the run-up to the May 2009 general elections. The government also plans to study the route to a more flexible exchange rate system free of multiple currency practices, drawing on the recent FSAP and based on IMF input in the context of the Article IV discussions scheduled for Spring 2009. The goal is to develop plans that could be implemented later in 2009, and which might be supported by a follow-up PRGF arrangement.

Staff supports the authorities' request for a one-year high-access ESF arrangement.

I. BACKGROUND

A. Retrospective: A Successful PRGF-Supported Program but Minimal Reserves

1. **Policy implementation during the 2005–08 PRGF arrangement constituted a sharp break from past performance.** In the first part of the decade poor program implementation led to large fiscal slippages, an unsustainable domestic debt spiral, and low investment. Despite numerous attempts to bring the 2000–03 PRGF arrangement back on track, the economy remained in disarray, so the arrangement lapsed with only one review completed. The government that took office in mid-2004 has greatly improved economic policy.

2. **The objectives of the PRGF arrangement were achieved except for the international reserve target.** The main factors behind the low international reserve coverage were much higher imports than projected, large cumulative terms of trade declines, and less budget support than expected (Figure 1). Over-borrowing relative to the initial fiscal targets was a contributing factor.[1] A lack of flexibility in the exchange rate interacted with these factors by pushing the burden of adjustment on to reserves. International reserves are too low considering Malawi's vulnerabilities to weather, terms of trade (TOT), and aid shocks. At just over one month of prospective imports or 6.1 percent of GDP, Malawi's reserves are among the lowest in Africa.

Malawi: Initial Program Targets[1] and Outcome 2005/06–07/08

	2005/06		2006/07		2007/08	
	Prog.	Act.	Prog.	Act.	Prog.	Prel.
GDP growth	5.2	5.0	6.8	7.7	5.8	8.7
Consumer prices (end of period)	11.0	15.3	10.8	7.6	7.4	8.5
Consumer prices (annual average)	15.1	16.1	5.8	10.0	7.9	7.7
International reserves in months of prospective imports	1.8	1.1	2.1	1.2	2.3	1.3
Government net domestic borrowing (after program adjusters, percent of revised GDP)	-0.4	0.3	-0.2	-0.3	-0.3	-0.3
Government net domestic debt (percent of revised GDP)	13.8	14.6	11.1	12.2	9.1	11.7

Source: Malawi authorities and staff estimates.

[1] As of the time of the request for the three-year Poverty Reduction and Growth Reduction Facility (IMF Country Report No. 05/285).

[1] To meet the original 2.4 months of imports reserve target for end-2007 an additional US$155 million (3.7 percent of 2008 GDP) in reserves would have been needed. For 2005–07 the cumulative terms of trade impact was US$217 million (5.1 percent of 2008 GDP), the cumulative shortfall in budget support was US$48 million (1.1 percent of 2008 GDP), while the cumulative over-borrowing relative to initial target was less than US$25 million (0.6 percent of 2008 GDP). The higher-than-projected imports were partly due to higher project aid than was initially assumed.

Figure 1. Malawi: External Developments, 2001–08

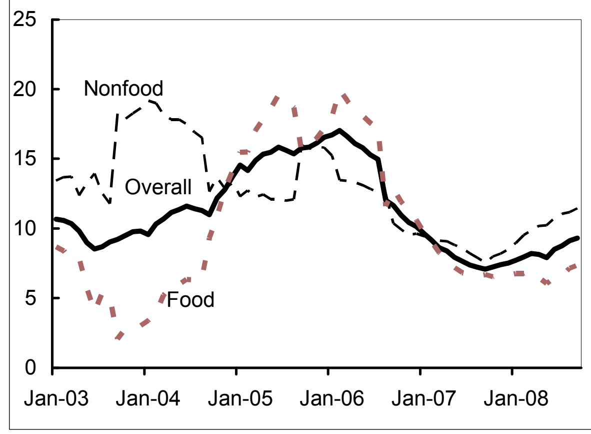
Sources: Malawi authorities and IMF staff estimates.

B. Recent Developments: A Severe Terms of Trade Shock

3. **Although Malawi's macroeconomic performance remains generally strong, the economy is feeling the impact of higher import prices**.

- Real GDP growth is still high and inflation moderate, though rising. Consumer prices increased by 9.3 percent in the 12 months to September 2008, largely because of a 25 percent increase in fuel prices in June 2008 (Figure 2). Food price inflation continues to be subdued, though domestic maize prices reportedly shot up in some areas in the first half of 2008.

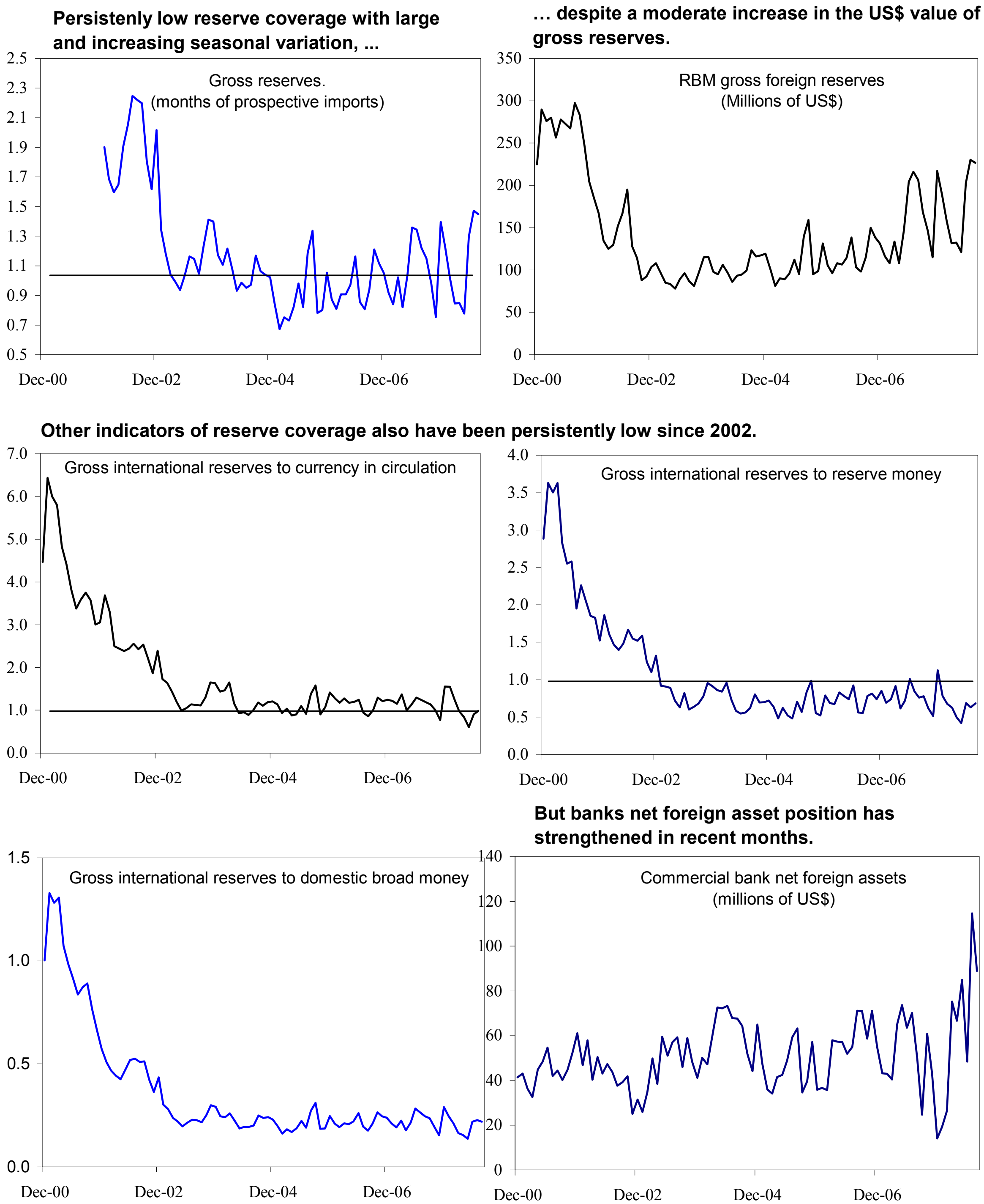
Figure 2. Malawi:Consumer Price Inflation 2003–08
(12-month percent change)



- The TOT deteriorated significantly in 2008, despite solid growth in tobacco prices and export volumes and the recent easing of world oil prices. It appears that tobacco exports in 2008 may be as much as US$632 million, up from US$365 million in 2007 and US$68 million higher than projected at the time of the 6th PRGF review. Nevertheless, high fertilizer prices and other world market prices for most of 2008 suggest that the negative impact on Malawi's 2008 trade balance could be US$156 million, slightly down from the $188 million estimated earlier (Table 1). Fertilizer bid prices during procurement were almost 51 percent higher than had been expected when the 2008/09 budget was prepared.

- The full TOT impact has not yet been felt because reserves have been buttressed by the seasonal concentration of tobacco proceeds in April-September. Still, gross reserves at the end of September were only US$175 million, 1.1 month of imports (Figure 3).

Figure 3. Malawi: International Reserves 2000–08



Source: Malawi authorities and IMF staff estimates.

Table 1. Malawi: Impact of the Change in Terms of Trade on the Trade Balance 2007–09[1]

	2007	2008		2009	
		CR No. 08/265	Update	CR No. 08/265	Update
US$ millions	-56.8	-188.4	-155.9	-45.5	198.1
Percent of GDP	-1.5	-4.6	-3.8	-1.0	4.4
Of which due to					
Oil prices					
US$ millions	-15.6	-103.0	-62.1	-20.6	77.1
Percent of GDP	-0.4	-2.5	-1.5	-0.4	1.7
Fertilizer prices					
US$ millions	-70.2	-26.6	-122.5	-15.6	102.7
Percent of GDP	-1.8	-0.6	-3.0	-0.3	2.3
Food prices					
US$ millions	3.1	-28.4	-22.8	5.2	14.9
Percent of GDP	0.1	-0.7	-0.5	0.1	0.3
Tobacco prices					
US$ millions	71.6	80.6	167.4	0.0	0.0
Percent of GDP	1.9	1.9	4.0	0.0	0.0
Other prices[2]					
US$ millions	-45.6	-111.0	-115.9	-14.5	3.3
Percent of GDP	-1.2	-2.7	-2.8	-0.3	0.1
Memorandum items:					
Oil price assumption (US$/Barrel)	71	117	100	125	68
Fertilizer price assumption (US$/metric ton)	650	750	1,131	850	771
Tobacco price assumption (US$/metric ton)	3,000	3,500	4,080	3,500	4,080

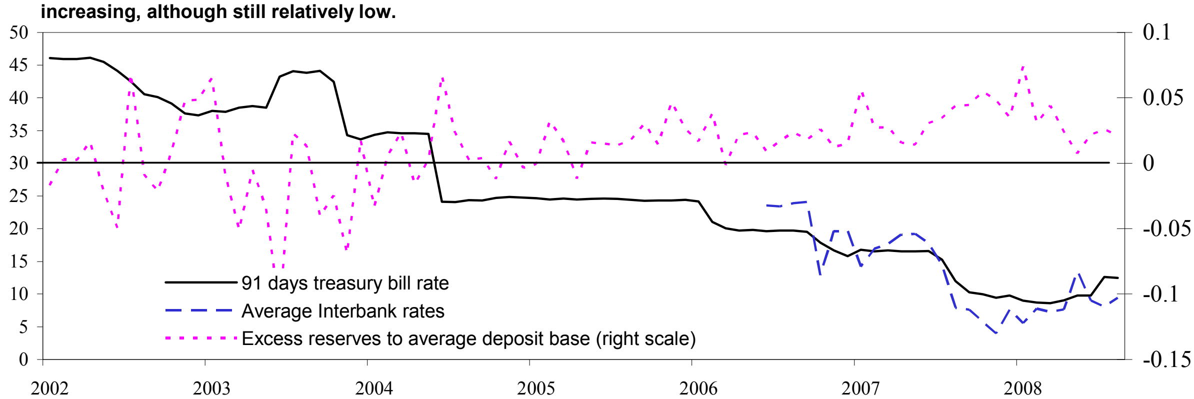
[1] In millions of US dollars unless otherwise noted. Assumes unchanged volumes.
[2] Includes other raw materials and manufactured products.

4. **Adjustment of macroeconomic policies in response to the TOT shock is well underway:**

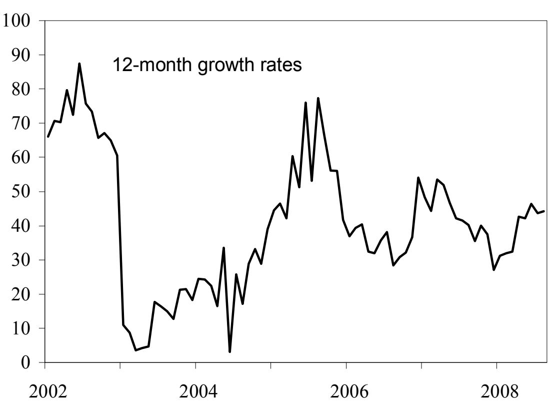
- The government met the end-June 2008 indicative domestic borrowing target.
- A tight budget for FY2008/09 has been approved despite significant political hurdles and a three-month delay caused by an impasse in Parliament; it is fully in line with staff recommendations during the 6th PRGF review.
- Monetary tightening continues. Excess reserves in the banking system that rose to unprecedented levels in 2007 and early 2008 have largely been mopped up. As a result, interbank and treasury bill rates rose to more prudent levels; the 91-day t-bill interest rate was 13.26 percent at the end of September, up 459 basis points since early April (Figure 4).
- Donors are augmenting their budget support to help finance the increased cost of the fertilizer and seed subsidy program.

Figure 4. Malawi: Monetary Developments, 2002–August 2008

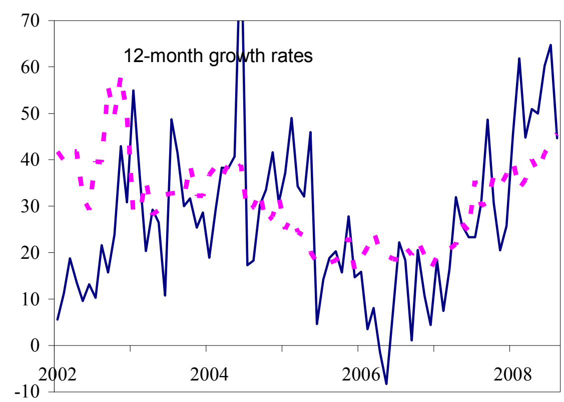
Excess reserves are being reduced after reaching record highs in 2007 and early 2008, and interest rates are increasing, although still relatively low.



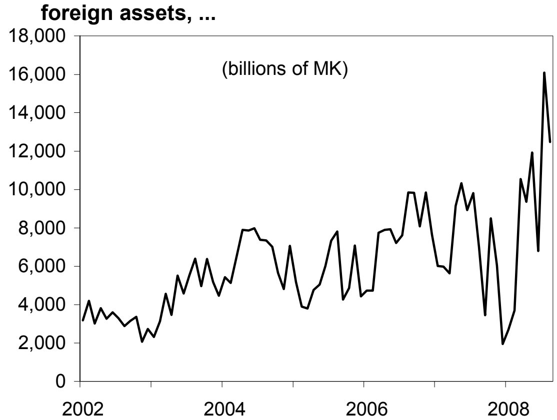
Private sector credit growth ...



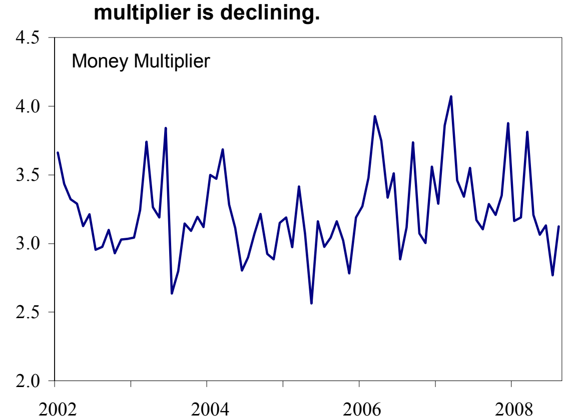
... and money growth remain high.



Commercial banks have sharply increased their net foreign assets, ...



... and a volatile end-of-period money multiplier is declining.



Sources: Malawi authorities and IMF staff estimates.

5. **The government has also taken some administrative measures to address food security concerns.** In an effort to reduce consumer prices and stop maize speculation, licenses that had allowed private traders to buy maize from smallholders have been revoked and prices fixed. Through a recent government directive, the state-owned Agricultural Development and Marketing Corporation (ADMARC) has been designated sole buyer of maize from smallholder farmers, as well as the predominant stockpiler and seller of maize in Malawi. The authorities have indicated that the directive is a temporary measure intended to ensure that public stockpiles of maize are adequate to meet food security needs. For the same reason, the government has also tightened the enforcement of maize import and export license requirements.

II. The ESF-Supported Program

6. **During the ESF arrangement the main focus of the government's program will be on adjusting to the TOT shock and starting to rebuild Malawi's international reserve buffer.** These goals are designed to support continuing financial and macroeconomic stability, growth, and poverty reduction. At the same time, the government is preparing a medium-term program to reform the money and foreign exchange markets. The main objectives of this program will be to remove the current multiple currency practice, introduce a more flexible exchange rate system, and modernize the monetary policy framework. Improving public financial management is crucial for ensuring financial stability, rebuilding international reserves, and achieving the Malawi Growth and Development Strategy (MGDS) targets. In the near term the government aims to strengthen budget control to ensure fiscal discipline in the run-up to the May 2009 general elections. Program conditionality is limited to areas critical for near-term adjustment to the shock.

A. Adjusting to the Terms of Trade Shock

7. **The program aims to bring import coverage of gross reserves at the end of 2009 roughly back to where it was at the end of 2007, while preserving growth and food security.** The TOT shock reduces real disposable income in Malawi, and domestic demand must decline accordingly to protect international reserves, unless additional external support becomes available. Thus, protecting, and ultimately building reserves, will require a combination of reduced domestic borrowing and monetary tightening. Staff emphasized that demand-switching measures—including structural reforms and quick pass-through of world market prices—that promote increased Malawi exports and reduced imports would help soften the impact of domestic demand compression on growth, employment, and poverty reduction. The June fuel price increase is helpful in that regard. It is equivalent to a 1½ – 2 percent decline in household real disposable income and a 1½ –3 percent depreciation of the real effective exchange rate.[2]

[2] Measured as the price of traded goods (including fuel) compared to nontraded goods.

8. **To help smooth the needed adjustment, the authorities are requesting a high-access one-year ESF arrangement of SDR 52.05 million (75 percent of the quota).** They have also requested additional donor support, particularly to help finance the seed and fertilizer subsidy program, which is critical for sustaining both agricultural production and export and food security. A substantial increase in aid is expected for 2008/09 in response to Malawi's solid performance during the PRGF arrangement and its substantial needs: support for projects, the National AIDS Commission, and the health sector-wide approach (SWAp) is projected to increase by US$147 million in FY2008/09 and budget support by US$120 million, including a top-up of US$42 million in response to rising fertilizer costs. Nevertheless, additional financial support to build reserves is much needed.

Growth and inflation outlook

9. **Given the lags in the agricultural production cycle that dominates the economy, any slowdown in growth in 2008 resulting from the TOT decline should be moderate.** However, the impact may be larger in 2009, particularly if there should be a major scale-back of fertilizer use. Growth is projected at about 8.7 percent in 2008, significantly higher than expected. The tobacco harvest was higher than projected, the maize harvest was solid, and growth in the first part of the year in other segments of the economy was better than envisaged, though it may have begun to slow. For 2009, growth of about 7.9 percent is expected, primarily because of the opening of the Kayelekera uranium mine; other segments of the economy are expected to slow.

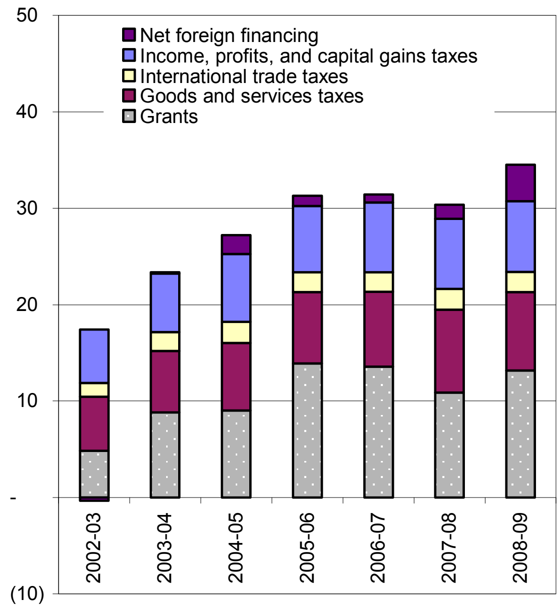
10. **Inflation is expected to ease over the medium term because world oil prices have been declining.** Malawi is expected to remain relatively insulated from current worldwide increases in food prices because it has been relatively self-sufficient with maize, its staple food, in recent years.

Fiscal policy adjustment

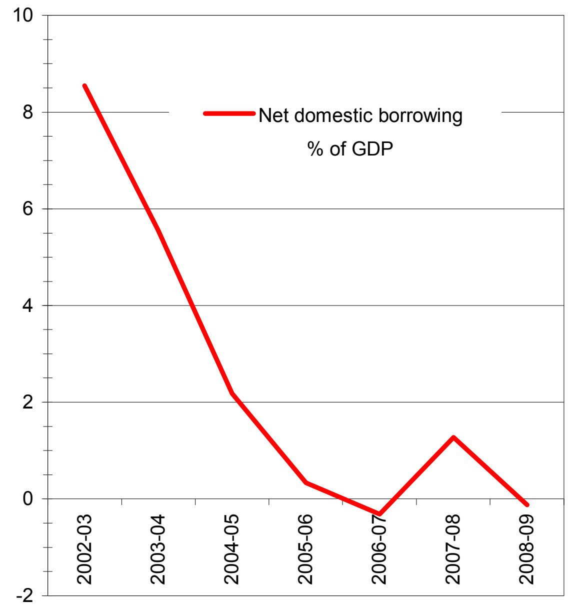
11. **Targeted domestic borrowing in 2008/09 is 1.4 percent of GDP lower than it was in 2007/08** (Figure 5). The government is adhering to the original domestic repayment target for 2008/09 despite a rise of US$70 million (1.7 percent of GDP) in fertilizer subsidy costs and higher than budgeted domestic interest payments (0.2 percent of GDP). The gap is being covered by higher-than-envisaged tax revenues (0.8 percent of GDP), about US$42 million (0.8 percent of GDP) of additional budget support, and spending cuts (0.4 percent of GDP). The program adjusters are set to allow the government to avoid some spending cuts if further budgetary support is forthcoming. On the other hand, the adjusters for shortfalls in budget support have been tightened to protect reserves.

Figure 5. Malawi: Fiscal Developments, 2002/03–2008/09

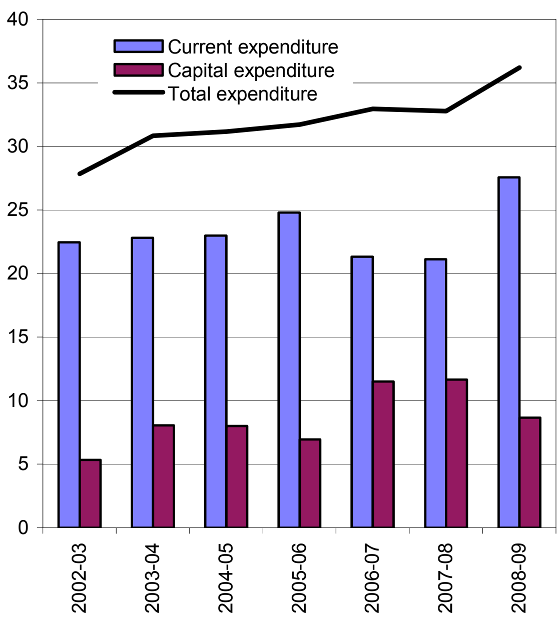
Robust revenue performance, and increasing grants and foreign financing ...



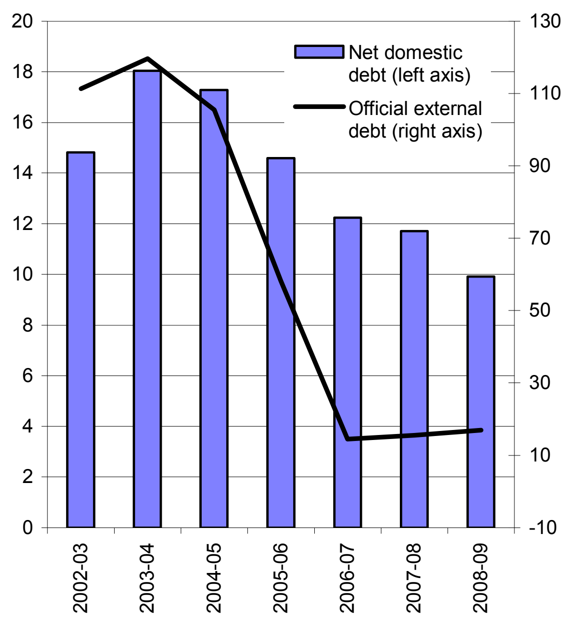
... allow further fiscal consolidation ...



… while at the same time supporting increased expenditures ...



… and rapid domestic debt reduction.



Sources : Malawi authorities and IMF staff estimates

Continued tight monetary policy

12. **Monetary policy has been tightened, and the authorities are prepared to tighten further if needed.** The increase in short-term interest rates resulting from the tightening already done should over time help reduce credit growth to levels more consistent with the reserve situation. Broad money is targeted to grow slightly less than nominal GDP over the near term.[3] Staff emphasized that uncertainty regarding future money demand, and the impact on the economy of the agreed monetary program, was large. The current high money growth may suggest either shifts in money demand or temporary liquidity hoarding. Thus, close monitoring of interest rate responses to the implementation of the program would be warranted. The authorities should stand ready to adjust, in close consultation with staff, the policy stance if needed.

Exchange rate policies

13. **The government continues to place substantial weight on stabilizing the nominal exchange rate against the U.S. dollar, which has held steady since May 2006.**[4] The authorities believe exchange rate stability has helped signal their commitment to economic stability and anchored inflation expectations and the prices of traded goods. Staff reiterated that a traditional pegged exchange rate regime would not be appropriate for Malawi, especially given its precariously low reserves and vulnerability to exogenous shocks. The real effective exchange rate (REER) has been relatively stable for the last four years, helped by the weakening of the U.S. dollar (Figure 6). During this period, rising aid and productivity have supported the real exchange rate, but declining TOT have outweighed these factors, as indicated by slow reserve accumulation. While the TOT worsening seems to be reversing, the brisk appreciation of the U.S. dollar against the currency of many of Malawi's trading partners may lead to a sizable appreciation of the Malawi REER. To the extent that this would hurt growth and poverty reduction in Malawi and make it harder to meet their medium-term reserve accumulation target, the authorities should be prepared to allow more exchange rate flexibility.

14. **The highly regulated foreign exchange market is not designed to reveal a market-clearing exchange rate.** This has caused a multiple currency practice and periodic foreign exchange shortages: parallel market spreads have recently increased sharply (Figure 7). The government plans to study the route to a more flexible foreign exchange rate regime free of the multiple-currency practice, drawing on the recent FSAP and on IMF input

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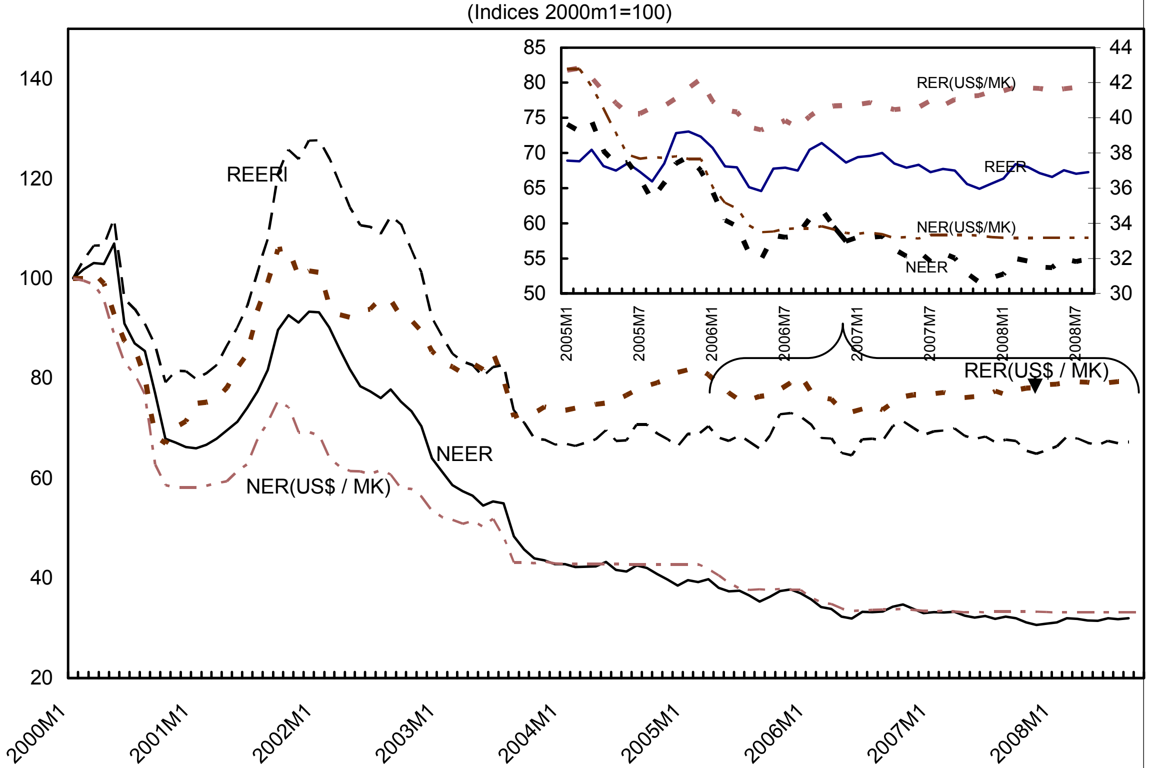
[3] To enhance control over monetary policy, monetary targets are set on a monthly average basis, not end-of-period, as was done under the PRGF arrangement).

[4] For this reason the exchange rate regime was recently reclassified as a de facto conventional peg.

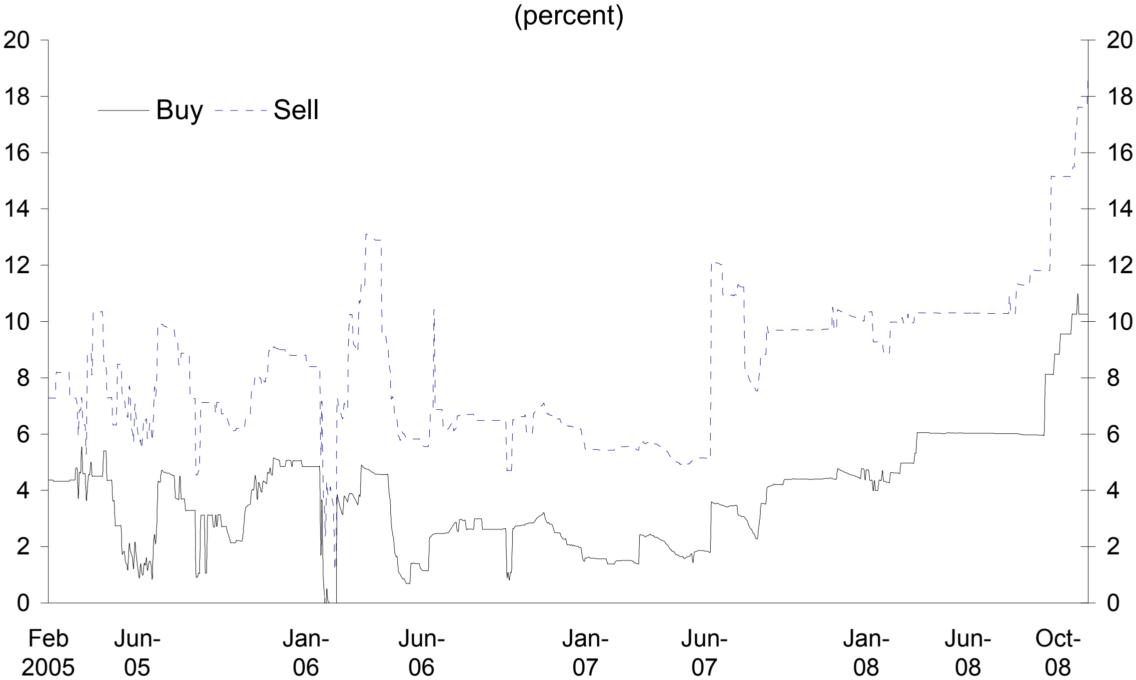
in the context of the Article IV discussions scheduled for Spring 2009. The goal is to develop plans that could be implemented later in 2009 .[5]

Figure 6. Malawi: Real and Nominal Effective Exchange Rate 2000–08
(Indices 2000m1=100)



[5] The 2009 Article IV consultation will provide a fuller assessment of the exchange rate and the regime.

Figure 7: Discount on Buy and Sell Rates: Feb. 2005–Nov. 2008
(percent)



Near term reserve outlook

15. **Gross reserves are expected to remain precariously low in the near term, despite policy adjustments and additional financial support**. This is because the April–September tobacco export season has ended and major near-term increases in imports are expected. High oil import costs are expected to persist for several months despite the recent drop in world prices because of long pricing lags in import contracts. Imports are also expected to rise in the last quarter of 2008 where the bulk of fertilizer imports is concentrated. Thus, gross reserves are expected to decline to about US$209 million by end-December 2008, and decline further in the first quarter of 2009, before rising to about US$257 million by mid-June 2009. Program adjusters have been tightened to prevent reserves from declining any further. The authorities are ready to take additional measures if the short-term outlook for reserves appears to be significantly worse than currently projected.

B. Building Reserves Over the Medium Term

16. **The authorities' near-term policy is guided by their objective of increasing Malawi's international reserves substantially over the medium term.** Bringing reserves in line with regional averages for coverage of aid shocks, TOT shocks, or imports would mean a substantial increase, to about 2.5–3 months of prospective imports, or 10–11 percent of GDP. The authorities would prefer an even larger reserve buffer given Malawi's vulnerability to shocks and large seasonal variations in net foreign exchange flows.

17. **The challenge is to balance the desired reserve accumulation against much-needed growth in propoor spending and adequate credit to the private sector.** Increasing reserves to the desired level would require a substantial increase in the saving-investment balance, adjusted for external concessional financing. With private investment low, forcing a substantial increase in the private sector saving-investment balance could hamper growth and thus poverty reduction. Therefore, to support the needed increase in international reserves, Malawi needs a substantial increase in the government saving-investment balance that is not financed by concessional external loans.[6] To strike a balance between these competing goals, staff and authorities agreed that the government's medium-term fiscal program should aim to further consolidate net domestic debt to allow for accumulating reserves over the medium term.

18. **Building reserves will also require longer-term structural adjustments.** Together with the World Bank and other partners, the authorities are working to ensure that the agriculture program will be both fiscally sustainable and meet food security objectives. They are also working to improve the functioning of the local grain market to reduce large seasonal variations in prices, both to ensure better prices to farmers in the harvesting season and to lower prices to consumers in the lean season. This should help improve food security and lower import needs.

C. Reforming Money and Foreign Exchange Markets and the Monetary Policy Framework

19. **Over the medium to long term, the Reserve Bank of Malawi (RBM) needs a more coherent exchange rate and monetary policy framework.** Key elements include a market-clearing exchange rate, probably under a managed float, and measures to anchor inflation expectations. This would require improving (i) the functioning of the interbank, foreign exchange, and securities markets, including through reform of the auction mechanisms; (ii) the monetary transmission mechanism, and understanding of it; (iii) RBM ability to forecast inflation and liquidity; and (iv) RBM policy instruments. The near-term focus will be on preparing the foundation for these reforms.

D. Strengthening Public Financial Management

20. **The near-term PFM focus will be on improved monthly monitoring of budget execution**. A project supported by technical assistance from East AFRITAC is underway to address the most urgent obstacles for reporting monthly budget execution. In the longer term, more far-reaching changes to the government accounting and reporting system are necessary. The authorities are also taking measures to improve revenue forecasting; project evaluation and costing; financial controls and audits; and procedures for amending budgets. These

[6] An increase in the government's saving-investment balance that is not financed by concessional external loans is, in fiscal accounting terms, a reduction in government net domestic borrowing.

measures, which are important to support fiscal discipline and the achievement of fiscal targets, are detailed in the authorities MEFP (attached).

III. Program Monitoring

A. Access and Capacity to Repay the Fund

21. **Access under the ESF would be set at 75 percent of quota (SDR 52.05 million), front-loaded with three drawings.** Malawi's financing needs caused by the unexpected TOT shock are exceptionally large despite the current sizable increase in donor support and prospective ESF-associated donor augmentation. In view of the projected seasonal dip in reserves, it is proposed that 50 percent of quota be made available on approval of the arrangement (Table 5a).

22. **Malawi has adequate capacity to repay the Fund**. After HIPC and MDRI debt relief, including topping–up, Malawi's stock of external debt fell from 104 percent of GDP at the end of 2005 to 14.3 percent a year later. Over the same period, the NPV of debt declined from 24.7 percent of GDP to about 6.7 percent of GDP, and from 190 percent of exports to 40.9 percent of exports. Repayment to the Fund will be negligible at about 0.1 percent of exports of goods and services.[7] By helping avert a disruptive adjustment and mobilize additional donor financing, the ESF would support Malawi's capacity to repay the Fund.

B. Program Monitoring and Conditionality

23. **Program implementation and its economic results will be subject to two reviews based on end-December 2008 and end-June 2009 performance criteria**. Quantitative performance criteria for December 2008 and June 2009 and indicative targets for December 2009 are set out in Table 1 of the attached MEFP and defined in the technical memorandum of understanding. The first review mission would be scheduled for March 2009.

C. Data Issues, Technical Assistance, and Capacity Building

24. **Data provided are adequate for surveillance and program monitoring purposes.** The quality and timeliness of the fiscal and monetary data needed to evaluate Malawi's program performance have improved, although their shortcomings are still significant. The government is also doing better at disseminating monetary and fiscal policy data. The authorities are committed to building technical capacity within the government and the RBM. They are receiving technical assistance from the Fund in several areas, primarily PFM, the exchange rate, monetary management, and statistics.

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[7] A new debt sustainability analysis is scheduled for the first part of 2009, in conjunction with the next Article IV consultation. Staff continuously monitors Malawi's domestic and external debt using the Debt Sustainability Framework.

D. Risks to the Program

25. **The main risks stem from the external environment, low and declining reserves, and the presidential and parliamentary elections in May 2009**. There are large uncertainties surrounding the impact on Malawi of the global financial crisis and the recent appreciation of the U.S. dollar. Malawi would be vulnerable to a softening of tobacco prices, less global demand for its exports, and a weakening of aid inflows. The large rise in aid in 2008/09, which is largely being spent, is increasing Malawi's vulnerability to future aid volatility. The near-term reserve outlook leaves little room for further economic shocks or policy slippages. Hence, the government will need to resist unrealistic spending pressures in the election year. Continued commitment to reform at the highest political levels will be crucial as the elections approach. Malawi's narrow export base and dependence on agriculture also leave it vulnerable to weather shocks. The authorities have expressed an interest in pursuing a follow-on arrangement with the IMF to address medium-term issues.

IV. Staff Appraisal

26. **Malawi faces significant balance of payments financing needs.** It is being hit hard by worsening terms of trade. Although the recent easing of world oil prices will over time help reduce pressure on the balance of payments, the near-term reserve outlook is challenging and could become even more challenging as the global financial crisis evolves.

27. **The government's near-term program appropriately aims to restore reserve coverage.** The current substantial tightening of monetary policies and contraction of domestic borrowing should over time help relieve pressure on the balance of payments. High-access ESF financial assistance and associated donor augmentation should help maintain financial stability in coming months, but there is considerable uncertainty. The authorities need to be prepared to take additional measures if international reserves end up being consistently lower than projected. In this context, more exchange rate flexibility would help soften the impact on growth, employment, and poverty reduction from the required domestic demand compression.

28. **Forceful measures are needed over the medium term to bring reserves up to levels that would adequately cover import needs and shocks to aid and the terms of trade.** Accumulating reserves will require sustained restrained domestic borrowing, enhanced foreign exchange market flexibility, and structural measures to encourage exports and reduce imports. In that regard, the government's plans for laying the foundation for reforming the foreign exchange and monetary markets are encouraging.

29. **Improving PFM is important for ensuring financial stability, rebuilding international reserves, and achieving government goals.** The authorities' plans for improved monitoring of budget execution and strengthening budget preparation and control are particularly important in that regard.

30. **Reforms to the agriculture support program are also needed to ensure that the program is fiscally sustainable and meets government food security objectives.** Reforms to the local grain market that would promote private sector development, reduce seasonal price variations, and ensure better prices to farmers and access to profitable export markets should over time help improve food security, increase pro-poor growth, and help build reserves.

31. **Given the authorities' commitment to continued sound economic management and the clear balance of payment needs, the staff recommends Executive Board approval of the request for a new one-year high-access ESF arrangement.** Staff believes the terms of trade shock meet the criteria specified in the PRGF-ESF Trust Instrument for users of ESF resources. The shock is exogenous and the primary cause of the large immediate, but temporary, worsening of the balance of payment.

Table 1a. Malawi: Selected Economic Indicators, 2006–10

	2006	2007	2008		2009	2010
	Act.	Prel.	CR No. 08/265	Proj.	Proj.	Proj.
National accounts and prices						
GDP at constant market prices	6.7	8.6	7.4	8.7	6.7	7.1
Nominal GDP (MK billions)	430.3	501.9	581.5	592.7	683.3	780.1
Nominal GDP per capita (US$)	241.1	267.8	299.9	308.9	347.9	375.6
GDP deflator	23.6	7.3	8.6	8.7	8.0	6.6
Consumer prices end of period)	10.1	7.5	8.2	8.4	6.7	6.6
Food	10.6	6.7	7.1	6.7	6.5	6.2
Nonfood	9.6	8.5	9.4	10.5	7.0	6.9
Consumer prices (annual average)	13.9	7.9	8.3	8.4	7.8	6.7
Investment and savings (percent of GDP)						
National savings	15.6	23.7	22.8	19.5	19.5	18.4
Government	7.1	11.1	6.0	4.1	7.4	6.9
Private	8.5	12.6	16.8	15.4	12.1	11.6
Gross investment	22.0	25.9	31.1	27.4	23.7	23.8
Government	7.7	14.3	9.8	9.2	9.8	10.1
Private	14.4	11.7	21.3	18.2	13.9	13.7
Saving-investment balance	-6.4	-2.2	-8.2	-8.0	-4.2	-5.4
Government	-0.5	-3.1	-3.8	-5.1	-2.4	-3.3
Private	-5.9	0.9	-4.5	-2.9	-1.8	-2.1
Central government (percent of GDP)						
Revenue (excluding grants)	17.5	18.7	18.9	19.1	19.5	19.6
Grants	13.5	14.1	11.9	9.9	13.0	11.7
Expenditure and net lending	31.6	36.0	34.6	34.2	35.0	34.6
Overall balance (excluding grants)	-14.2	-17.2	-15.6	-15.1	-15.5	-15.0
Overall balance	-0.7	-3.1	-3.8	-5.1	-2.4	-3.3
Foreign financing	0.0	2.3	2.4	2.2	3.9	3.4
Domestic financing	0.7	0.4	1.6	3.0	-1.5	-0.1
Money and credit (contribution to M2 growth)						
Money and quasi money	16.5	36.9	15.4	26.8	7.9	11.5
Net foreign assets	18.0	5.9	-10.3	-11.2	12.0	9.0
Net domestic assets	-1.4	31.0	25.7	38.0	-4.1	2.5
Credit to the government	-10.5	1.7	9.7	18.4	-4.2	-3.1
Credit to the rest of the economy	21.2	16.4	10.6	17.5	10.5	7.6
Velocity	5.5	4.7	5.9	4.4	4.7	4.6
Money and credit (percent change)						
Money and quasi money	16.5	36.9	15.4	26.8	7.9	11.5
Net foreign assets	103.8	19.5	-33.8	-42.4	99.6	43.5
Net domestic assets	-1.7	44.4	37.1	51.6	-4.6	3.1
Credit to the government	-25.0	6.1	40.4	87.3	-13.5	-11.3
Credit to the rest of the economy	57.1	32.8	25.0	36.0	20.1	13.1
Velocity	5.5	4.7	5.9	4.4	4.7	4.6
External sector (millions of US$)						
Exports, f.o.b.	543.9	725.5	858.7	1,003.5	1,067.7	1,171.9
Imports, c.i.f.	-1,080.3	-1,181.9	-1,673.5	-1,436.4	-1,461.5	-1,628.5
Usable gross official reserves	130.3	217.1	156.1	209.0	345.1	412.7
(months of imports)	1.1	1.4	0.9	1.3	2.0	2.3
Current account	-6.4	-2.2	-8.2	-8.0	-4.2	-5.4
Current account (excluding official transfers)	-19.7	-16.3	-20.1	-17.9	-17.2	-17.0
Nominal effective exchange rate	-11.1	-6.4	...	...	...	...
Real effective exchange rate	-5.1	-4.4	...	...	...	...
Impact of change in terms of trade on trade balance (percent of GDP)	-1.4	-1.5	-4.6	-3.8	4.4	...
Debt stock and service (percent of GDP)						
External debt (public sector)	14.3	14.5	17.0	16.5	17.4	19.4
NPV of debt (percent of avg. exports)	40.9	41.6	51.5	51.5	62.6	72.4
External debt service (percent of exports)	14.1	3.2	2.9	2.9	3.3	3.7
Net domestic debt (central government)	12.6	11.9	16.7	18.1	14.2	12.3
Of which: excluding recapitalization of RBM	12.6	11.9	11.6	13.1	9.9	8.5
Net consolidated domestic debt (central bank and central government)	12.8	14.8	9.5	10.4	8.8	7.7
Domestic interest payment	0.0	2.3	2.4	2.2	3.9	3.4
Treasury bill rate (period average)	20.0	13.9	... ...	...	...	...

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

Table 1b. Malawi: Selected Economic Indicators on a Fiscal Year Basis, 2005/06–2009/10

	2005/06	2006/07	2007/08		2008/09		2009/10
	Act.	Est.	CR No. 08/265	Prel.	CR No. 08/265	Proj.	Proj.
			(Percent change, unless otherwise specified)				
National accounts and prices							
GDP at constant market prices	5.0	7.7	7.6	8.7	7.6	7.6	6.9
Nominal GDP (MK billions)	378.3	466.1	540.1	547.3	630.3	638.0	731.7
Nominal GDP per capita (US$)	226.4	252.8	284.7	288.5	313.9	329.0	363.8
GDP deflator	17.4	14.6	8.0	8.0	8.5	8.3	7.3
Consumer prices end of period)	15.3	7.6	8.7	8.5	8.0	8.5	6.6
Food	17.5	6.8	6.2	6.5	7.9	7.3	6.0
Nonfood	12.8	8.6	11.5	10.7	8.2	9.7	7.1
Consumer prices (annual average)	16.1	10.0	7.7	7.7	8.2	8.4	7.0
Investment and savings (percent of GDP)							
National savings	13.9	21.7	23.7	21.5	21.1	18.6	19.8
Government	6.9	10.3	10.7	8.9	6.0	5.0	8.3
Private	7.0	11.4	12.9	12.6	15.2	13.6	11.5
Gross investment	23.0	24.4	29.0	26.9	28.0	24.5	24.6
Government	6.9	11.5	12.9	11.7	9.3	8.7	10.8
Private	16.0	12.9	16.2	15.2	18.6	15.9	13.8
Saving-investment balance	-9.0	-2.7	-5.4	-5.3	-6.9	-6.0	-4.8
Government	0.0	-1.2	-2.2	-2.7	-3.4	-3.7	-2.5
Private	-9.0	-1.5	-3.2	-2.6	-3.5	-2.3	-2.3
Central government (percent of GDP)							
Revenue (excluding grants)	17.8	18.1	19.6	19.2	18.7	19.4	19.5
Grants	13.9	13.6	13.2	10.9	14.8	13.2	12.2
Expenditure and net lending	31.7	33.0	34.9	32.8	36.9	36.2	34.2
Overall balance (excluding grants)	-13.9	-14.9	-15.3	-13.6	-18.2	-16.9	-14.7
Overall balance	0.0	-1.3	-2.1	-2.7	-3.4	-3.7	-2.5
Foreign financing	1.0	0.8	1.5	1.4	3.7	3.8	3.5
Domestic financing	-1.0	0.5	0.7	1.3	-0.3	-0.1	-1.0
Money and credit (contribution to M2 growth)							
Money and quasi money	18.7	24.7	31.3	41.3	12.8	9.5	13.7
Net foreign assets	9.3	19.7	-12.1	-2.6	9.2	-4.1	11.0
Net domestic assets	9.4	5.0	43.3	43.9	3.7	13.6	2.7
Credit to the government	-17.8	-9.8	21.9	51.2	2.0	0.9	0.5
Credit to the rest of the economy	13.1	18.9	19.1	22.3	8.9	13.1	9.0
Velocity	5.3	5.1	5.8	4.3	6.0	4.6	4.7
Money and credit (percent change)							
Money and quasi money	18.7	24.7	31.3	41.3	12.8	9.5	13.7
Net foreign assets	57.1	91.4	-31.1	-7.8	45.0	-18.9	68.9
Net domestic assets	11.2	6.3	70.8	65.7	4.6	17.3	3.2
Credit to the government	-31.0	-29.2	115.0	101.5	3.2	3.2	1.8
Credit to the rest of the economy	37.6	46.8	46.2	46.8	19.3	26.5	15.8
External sector (millions of US$)							
Exports, f.o.b.	516.8	610.0	773.0	829.4	913.0	1,030.6	1,104.2
Imports, c.i.f.	-1,046.0	-1,140.7	-1,454.0	-1,274.4	-1,738.9	-1,447.5	-1,536.8
Usable gross official reserves	141.2	181.3	135.0	202.6	213.8	256.5	371.2
(months of imports)	1.1	1.2	0.7	1.3	1.1	1.5	2.0
Current account	-9.0	-2.7	-5.4	-5.3	-6.9	-6.0	-4.8
Current account (excluding official transfers)	-20.7	-16.4	-18.2	-17.2	-20.0	-17.5	-17.1
Nominal effective exchange rate	-11.1	-2.6	...	-1.4	...	...	...
Real effective exchange rate	-1.1	0.8	...	-1.2	...	...	...
Domestic debt (percent of GDP)							
Net domestic debt (central government)	14.6	12.2	16.8	17.1	13.6	14.6	11.7
Of which: excluding recapitalization of RBM	14.6	12.2	11.3	11.7	8.8	9.9	7.7
Net consolidated domestic debt (central bank and central government)	13.8	14.6	10.3	11.6	7.5	7.8	6.4
Domestic interest payment	4.0	3.1	2.0	2.1	2.4	2.6	2.1
Treasury bill rate (period average)	24.4	20.9	...	...	...	...	...

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

Table 2a. Malawi: Central Government Operations 2006/07–2009/10

	2006/07	2007/08		2008/09			2009/10	2010/11
(MK millions)	Outturn	CR No. 09/265	Prel. outturn	H1 Projection	Projection	Budget	Projection	Projection
Total revenue and grants	147,632	176,894	164,554	99,413	207,608	208,072	231,908	269,873
Revenue	84,295	105,741	104,954	57,457	123,536	118,167	142,541	164,899
Tax revenue	77,321	96,100	96,387	52,256	112,299	107,300	128,794	145,483
Pension contributions	0	0	0	0	0	0	0	0
Non-tax revenue	6,974	9,641	8,567	5,201	11,237	10,867	13,747	19,415
Grants	63,337	71,153	59,600	41,956	84,073	89,905	89,367	104,975
Budget support	9,079	14,360	12,901	13,651	21,187	19,440	17,849	26,240
Project	23,853	31,599	24,225	14,166	31,347	31,318	39,823	37,961
Dedicated grants	19,807	25,193	22,474	14,139	31,539	39,147	31,694	40,774
HIPC debt relief	2,459	0	0	0	0	0	0	0
Total expenditure and net lending	153,580	188,479	179,397	123,388	231,084	229,525	250,191	267,411
Current expenditure	99,464	119,186	115,622	93,365	175,827	172,306	171,191	186,839
Wages and salaries	23,778	30,000	30,018	18,609	37,256	37,256	40,255	43,319
Interest payments	16,378	11,768	12,331	7,766	17,416	16,169	16,908	14,798
Domestic	14,470	11,000	11,625	7,361	16,583	15,368	15,674	13,487
Foreign	1,908	768	706	404	833	669	1,234	1,311
Goods and services	30,641	45,000	42,042	35,035	68,627	77,703	66,319	76,287
Subsidies and other current transfers	23,009	31,218	30,144	31,825	52,241	40,891	47,380	52,062
Of which: fertilizer and seed subsidy	8,824	15,018	14,681	20,349	29,411	19,430	21,196	22,486
Arrears adjustment	5,657	1,200	1,086	131	287	287	329	372
Development expenditure	53,665	69,400	63,775	30,023	55,256	57,219	78,999	80,572
Part I (foreign financed)	42,218	52,800	45,135	20,281	43,119	44,082	65,080	64,848
Part II (domestically financed)	11,447	16,600	18,641	9,742	12,137	13,137	13,920	15,724
Net lending	452	-108	0	0	0	0	0	0
Fiscal space/unidentified measures	...	...	...	...	...	...	188	22,833
Overall balance (including grants)	-5,948	-11,585	-14,843	-23,975	-23,475	-21,453	-18,470	-20,370
Total financing (net)	5,672	11,585	14,777	23,975	23,475	21,453	18,470	20,370
Foreign financing (net)	3,761	982	7,822	10,662	24,279	22,863	25,793	29,524
Borrowing	11,073	11,142	8,686	11,640	25,924	24,503	27,564	30,456
Program	0	0	0	2,981	8,604	7,193	4,285	6,091
Project	11,073	8,690	8,686	6,586	13,172	13,165	23,279	24,365
Other concessional	...	...	...	2,073	4,147	4,145	0	0
Amortization	-7,312	-857	-864	-977	-1,645	-1,640	-1,771	-932
Domestic financing (net)	-1,453	3,753	6,956	13,313	-804	-1,410	-7,323	-9,154
Other financing	3,364	0	0	0	0	0	0	0
Discrepancy	276	0	66	0	0	0	0	0
Memorandum items:								
Nominal GDP	466,088		547,259		637,958		731,666	826,475
Net domestic debt [1]	57,094		93,766		92,963		85,640	76,486

Sources: Malawian authorities and IMF staff estimates.

[1] Excluding recapitalization of the RBM.

Table 2b. Malawi: Central Government Operations, 2006/07–2009/10

	2005/06	2006/07	2007/08			2008/09		2009/10
(Percent of GDP)	Outturn	Outturn	CR No. 08/265	Prel. outturn	H1 Projection	Projection	Budget	Projection
Total revenue and grants	31.7	31.7	32.3	30.1	15.6	32.5	32.6	31.7
Revenue	17.8	18.1	19.3	19.2	9.0	19.4	18.5	19.5
Tax revenue	15.8	16.6	17.6	17.6	8.2	17.6	16.8	17.6
Pension contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-tax revenue	2.0	1.5	1.8	1.6	0.8	1.8	1.7	1.9
Grants	13.9	13.6	13.0	10.9	6.6	13.2	14.1	12.2
Budget support	3.7	1.9	2.6	2.4	2.1	3.3	3.0	2.4
Project	2.9	5.1	5.8	4.4	2.2	4.9	4.9	5.4
Dedicated grants	5.3	4.2	4.6	4.1	2.2	4.9	6.1	4.3
HIPC debt relief	2.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	31.7	33.0	34.4	32.8	19.3	36.2	36.0	34.2
Current expenditure	24.8	21.3	21.8	21.1	14.6	27.6	27.0	23.4
Wages and salaries	5.3	5.1	5.5	5.5	2.9	5.8	5.8	5.5
Interest payments	4.8	3.5	2.2	2.3	1.2	2.7	2.5	2.3
Domestic	4.0	3.1	2.0	2.1	1.2	2.6	2.4	2.1
Foreign	0.8	0.4	0.1	0.1	0.1	0.1	0.1	0.2
Goods and services	8.8	6.6	8.2	7.7	5.5	10.8	12.2	9.1
Subsidies and other current transfers	5.0	4.9	5.7	5.5	5.0	8.2	6.4	6.5
Of which: fertilizer and seed subsidy	1.8	1.9	2.7	2.7	3.2	4.6	3.0	2.9
Arrears adjustment	0.8	1.2	0.2	0.2	0.0	0.0	0.0	0.0
Development expenditure	6.9	11.5	12.7	11.7	4.7	8.7	9.0	10.8
Part I (foreign financed)	5.9	9.1	9.6	8.2	3.2	6.8	6.9	8.9
Part II (domestically financed)	1.0	2.5	3.0	3.4	1.5	1.9	2.1	1.9
Net lending	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	0.0	-1.3	-2.1	-2.7	-3.8	-3.7	-3.4	-2.5
Total financing (net)	1.8	1.2	2.1	2.7	3.8	3.7	3.4	2.5
Foreign financing (net)	1.0	0.8	0.2	1.4	1.7	3.8	3.6	3.5
Borrowing	3.7	2.4	2.0	1.6	1.8	4.1	3.8	3.8
Program	0.9	0.0	0.0	0.0	0.5	1.3	1.1	0.6
Project	2.8	2.4	1.6	1.6	1.0	2.1	2.1	3.2
Other concessional	...	...	...	...	0.3	0.7	0.6	0.0
Amortization	-2.7	-1.6	-0.2	-0.2	-0.2	-0.3	-0.3	-0.2
Domestic financing (net)	0.3	-0.3	0.7	1.3	2.1	-0.1	-0.2	-1.0
Other financing	0.1	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Discrepancy	-1.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP	378,278	466,088		547,259		637,958		731,666
Net domestic debt [1]	55,183.0	57,094.1		93,766		92,963		85,640

Sources: Malawian authorities and IMF staff estimates

[1] Excluding recapitalization of the RBM

Table 3a. Malawi : Monetary Authorities' Balance Sheet, 2006–10

(MK millions, unless otherwise indicated)

	2006	2007				2008			2009	2009	2010
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q4	Q2	Q4	Q4
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.
Reserve money	21,522	20,391	25,797	30,231	27,058	29,524	41,340	40,602	42,461	42,937	48,259
Currency outside banks	14,653	13,600	19,993	20,777	19,561	18,926	31,545	...	...	...	...
Cash in vault	3,380	2,476	3,117	2,834	4,641	3,377	3,695	...	...	...	...
Commercial bank deposits with RBM	3,489	4,314	2,687	6,620	2,855	7,220	6,100	...	...	...	...
Net foreign assets (NFA)	15,543	13,932	21,391	18,920	25,763	11,283	21,162	10,449	17,137	26,269	38,517
NFA (US$ millions)	111.5	99.8	171.6	135	184	80	151	74	122	184	258
Gross foreign assets	131.3	133.9	204.4	169	217.1	131.7	202.7	209	257	345	413
Foreign liabilities	-19.8	-34.1	-32.8	-33	-33	-51	-52	-135	-135	-161	-155
Net domestic assets	5,979	6,459	4,405	11,311	1,294	18,241	20,179	30,153	25,324	16,669	9,742
Credit to government (net) [1]	7,460	8,503	-2,361	5,903	-816	40,937	35,689	35,632	35,602	36,955	35,136
Credit to statutory bodies (net)	0	0	156	1,249	1,266	-34	1,132	1,153	1,163	1,220	1,371
Credit to domestic banks	22	2	2,655	2	109	1	1,164	302	304	319	359
Other items (net) [1]	-1,502	-2,046	3,956	4,157	736	-22,663	-17,806	-6,934	-11,745	-21,826	-27,123
Revaluation accounts	0	37	0	94	-58	189	73	0	0	0	0
Open market operations	-8,074	-9,136	-8,631	-9,881	-13,965	-9,160	-5,216	9,972	7,578	314	783
Encumbered reserves	415	416	2,798	4,673	4,959	3,911	2,751	0	0	0	0
IMF MDRI relief											
Others	6,157	6,637	9,789	9,271	9,800	-17,604	-15,414	-16,906	-19,322	-22,140	-27,906
Of which: excluding recapitalization bonds		6,637	9,789	9,271	9,800	11,596	13,786	12,294	9,878	7,060	1,294
Memorandum items:									0		
Seasonally adjusted reserve money	22,369	24,785	26,147	29,936	28,458	35,997	41,912	42,703	43,049	45,159	50,757
Quarterly change	11.2	10.8	5.5	14.5	-4.9	26.5	16.4	2.3	0.9	2.9	2.8
Annual change	6.0	16.8	23.3	48.8	27.2	45.2	60.3	50.1	2.7	5.8	12.4
Seasonally adjusted currency outside banks	36,443	38,630	40,131	19,149	20,359	22,147	28,136	...	...	...	...
Quarterly change	17.2	6.0	3.9	7.0	6.3	8.8	27.0	...	...	...	...
Annual change	54.6	54.0	41.7	31.3	33.5	38.9	57.3	...	...	...	...
Net foreign assets at program exchange rate	15,543	13,932	21,109	16,646	25,808	11,290	21,171	10,446	17,133	25,843	36,224
Net domestic assets at program exchange rate	5,979	6,459	4,688	13,584	1,250	18,235	20,170	30,156	25,329	17,094	12,035
Money multiplier	3.56	4.07	3.55	3.3	3.9	3.8	3.1	3.3	3.3	3.3	3.4
Seasonally adjusted	3.55	3.50	3.44	3.3	3.8	3.2	3.0	3.2	3.2	3.2	3.3
Net sales [2]											
Quarterly change	3,137	15,184	775	1,613	4,584	-5,211	-6,294	-66	-7,607	1,938	9,593
Annual change	14,768	25,888	28,690	20,709	22,156	1,761	-5,309	-13,324	-13,510	-1,630	329

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

[1] Includes recapitalization of RBM with a transfer of T-bills in the amount of MK29.3 billion in January 2008

[2] Defined as the increase in holdings at cost value of both treasury and RBM bills in the private sector.

Table 3b. Malawi : Monetary Survey, 2006–10

(MK millions, unless otherwise indicated)

	2006	2007	2008			2009	2009	2010
	Q4		Q1	Q2	Q4	Q2	Q4	Q4
	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.
Money and quasi-money	76,624	104,880	112,592	129,462	132,977	141,726	143,458	164,488
Money	37,226	54,016	53,752	68,086	...	...	...	...
Quasi money	39,398	50,863	58,840	61,376	...	...	...	...
Of which: foreign currency deposits	12,047	17,173	17,162	22,437	...	...	...	...
Net foreign assets (NFA)	23,200	27,726	21,836	27,953	15,974	22,662	31,884	43,852
NFA (US$ millions)	151.8	198	155	199	114	161	223	293
Gross foreign assets	190.5	273	237	284	259	307	395	470
Foreign liabilities	-38.7	-75	-82	-85	-145	-145	-172	-177
Monetary authorities	15,543	25,763	11,283	21,162	10,449	17,137	26,269	38,517
NFA of the monetary authorities (US$ millions)	111.5	184	80	151	74	122	184	258
Gross foreign assets	131.3	217	132	203	209	257	345	413
Foreign liabilities	-19.8	-33	-51	-52	-135	-135	-161	-155
Commercial banks	7,657	1,963	10,552	6,791	5,525	5,525	5,615	5,336
NFA of the commercial banks (US$ millions)	40.2	14	75	48	39	39	39	36
Gross foreign assets	59.1	56	105	82	50	50	50	57
Foreign liabilities	-18.9	-42	-30	-33	-11	-11	-11	-22
Net domestic assets	53,424	77,153	90,756	101,509	117,003	119,064	111,575	120,636
Credit to government (net)	20,785	22,057	67,697	64,349	70,513	65,462	64,938	65,519
Credit to statutory bodies (net)	1,212	3,737	2,542	3,985	4,266	4,343	4,602	5,277
Credit to private sector	37,189	47,267	47,987	59,947	65,111	76,499	78,716	91,790
Other items (net)	-5,762	4,093	-27,470	-26,772	-22,887	-27,241	-36,682	-41,950
RBM's revaluation accounts	0	-58	189	73	0	0	0	0
Open market operations	-5,074	-5,539	-6,752	-3,716	4,484	2,546	-4,077	-3,579
Encumbered reserves	415	4,959	3,911	2,751	0	0	0	0
IMF MDRI relief								
Others	-1,104	4,731	-24,818	-25,879	-27,371	-29,787	-32,605	-38,371
Memorandum items:								
Seasonally adjusted broad money	78,074	106,973	116,320	126,692	135,631	138,098	146,322	167,771
Quarterly change	3.9	8.8	8.1	8.9	2.8	1.4	3.4	3.3
Annual change	16.8	36.5	37.6	42.2	26.8	9.0	7.9	14.7
Seasonally adjusted credit to private sector	36,443	46,322	51,576	58,369	63,809	74,815	77,143	89,954
Quarterly change	17.2	8.0	11.6	13.2	0.7	-0.1	1.0	3.0
Annual change	54.6	34.1	35.2	45.4	37.8	28.2	20.9	16.6
Velocity of money (annual GDP divided by seasonally adjusted trend-smoothed end-period broad money)	5.51	4.7	4.5	4.3	4.4	4.6	4.7	4.6

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

Table 4a. Malawi: Balance of Payments, 2006–10

(Millions of US$, unless otherwise indicated)

	2006	2007		2008	2009	2010
	Act.	CR No. 08/3	Prel.	Proj.	Proj.	Proj.
Current account balance (including grants)	**-202.9**	**-112.6**	**-80.4**	**-335.5**	**-205.4**	**-286.3**
Current account balance excluding grants	-623.0	-577.5	-584.3	-754.4	-835.5	-909.7
Merchandise trade balance	-536.3	-528.7	-456.3	-432.9	-393.8	-456.6
Exports	543.9	628.3	725.5	1003.5	1067.7	1171.9
Of which: Tobacco	289.7	279.0	323.8	632.4	623.8	642.5
Imports	-1080.3	-1157.0	-1181.9	-1436.4	-1461.5	-1628.5
Services balance	-245.1	-235.8	-256.3	-439.9	-548.2	-602.0
Interest public sector (net)	-21.4	-4.2	-4.5	-5.6	-7.1	8.4
Other factor payments (net)	-17.0	-18.2	-18.4	-75.0	-180.1	-241.8
Nonfactor (net)	-206.7	-213.5	-233.3	-359.2	-361.0	-368.5
Receipts	58.1	60.2	70.0	64.3	65.5	68.7
Payments	-264.8	-273.7	-303.3	-423.6	-426.6	-437.2
Unrequited transfers (net)	578.5	652.0	632.2	537.2	736.6	772.3
Private (net)	158.4	187.0	128.4	118.3	106.5	148.9
Receipts	170.5	199.4	144.5	144.6	132.7	175.7
Payments	-12.1	-12.4	-16.2	-26.2	-26.2	-26.8
Official (net)	420.1	464.9	503.9	418.8	630.1	623.4
Receipts	420.1	464.9	503.9	418.8	630.1	623.4
Budget support	72.0	82.8	103.8	101.0	148.0	95.7
Project related	348.1	382.2	400.1	317.8	482.2	527.8
Capital account balance (incl. errors and omissions)	**153.0**	**171.6**	**100.7**	**267.1**	**314.9**	**344.0**
Medium- and long-term flows	72.9	142.0	69.0	47.3	174.7	236.7
Disbursements	137.9	155.6	80.5	57.1	186.59	244.6
Budget support	24.5	9.0	0.0	21.2	55.0	33.0
Project support	62.0	79.6	91.4	80.9	131.6	156.6
Other medium-term loans	0.0	0.0	-5.8	0.0	0.0	55.0
Other investment assets	51.4	67.0	-5.1	-45.0	0.0	0.0
Amortization [1]	-65.0	-13.6	-11.4	-9.8	-11.9	-7.9
Foreign direct investment and other inflows	29.1	31.8	31.7	220.0	140.0	107.0
MDRI debt forgiveness on debt due after current year	1864.0	383.0	383.0			
Other liabilities (MDRI-IDA, IMF, and ADF loans)	-1864.0	-383.0	-383.0	0.0	0.0	
Short-term capital and errors and omissions	50.9	0	0	0	0	0
Overall balance	**-50.0**	**59.0**	**20**	**-68.4**	**109.5**	**57.7**
Financing (- increase in reserves)	**49.2**	**-59.0**	**-20**	**68.4**	**-109.5**	**-70.3**
Central bank	-34.5	-63.0	-64.6	109.5	-109.5	-73.9
Gross reserves (- increase)	24.9	-90.6	-82.8	8.2	-136.1	-67.6
Liabilities	-59.4	27.6	18.2	101.3	26.6	-6.3
Of which: IMF (net)	-59.5	27.6	10.1	95.2	15.9	0.0
Purchases/drawings	14.4	27.6	10.1	95.2	15.9	0.0
Repurchases/repayments	-73.9	0.0	0.0	0.0	0.0	0.0
Commercial banks	-16.1	-4.1	42.0	-41.1	0.0	3.6
Arrears	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	99.9	5.9	2.3	0.0	0.0	0.0
Financing gap (+ underfinanced)	**0.7**	0.0	**0.0**	**0.0**	**0.0**	**12.5**
Memorandum items:						
Gross official reserves						
Millions of US$	134.3	224.5	217.1	209.0	345.1	412.7
Months of imports [2]	1.1	1.7	1.4	1.3	2.0	2.3
Petroleum spot price (APSP)	64.3		71.1	99.8	68.0	
Current account balance (percent of GDP)						
Excluding official transfers	-19.7	-16.3	-16.3	-17.9	-17.2	-17.0
Including official transfers	-6.4	-3.2	-2.2	-8.0	-4.2	-5.4
Debt						
NPV of total debt as percent of exports of GNS	137.8		32.5	29.3	30.0	31.8
NPV of old debt after HIPC as percent of exports of GNS	133.8		24.9	18.5	14.0	10.9
NPV of new debt as percent of exports of GNS	4.0		7.6	10.8	16.0	20.9
External debt						
NPV of total debt-to-GDP	24.7		6.6	9.2	10.7	12.3
NPV of total debt-to-exports of GNS	130.1		41.6	51.5	62.6	72.4

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

[1] For years before 2007 debt service due before HIPC debt relief

[2] Months of prospective imports of goods and services.

Table 4b. Malawi: GrossFinancing Requirements and Sources of Financing, 2006–10

(Millions of US$)

	2006	2007		2008	2009	2010
	Proj.	CR No. 08/3	Prel.	Proj.	Proj.	Proj.
Gross financing requirements	**-2617.1**	**-1071.0**	**-1011.3**	**-791.0**	**-972.9**	**-987.9**
Gross financing requirements(excluding HIPC/MDRI)	**-753.1**	**-685.8**	**-628.3**	**-791.0**	**-972.9**	**-987.9**
External current account deficit (excl. official transfers)	-623.0	-577.5	-584.3	-754.4	-835.5	-909.7
Of which: trade balance on goods and services	-743.1	-742.2	-689.7	-792.1	-754.8	-825.2
Official debt amortization	-2002.9	-398.8	-394.4	-9.8	-11.9	-7.9
Of which: IMF repurchases and repayments	-73.9	0.0	0.0	0.0	0.0	0.0
MDRI debt repayment	-1864.0	-385.2	-383.0	0.0	0.0	0.0
Other, including reserves	8.8	-94.7	-32.6	-26.8	-125.5	-70.3
Gross reserves (after terms of trade shock)	24.9	-90.6	-82.8	8.2	-136.1	-67.6
Gross liabilities (excluding IMF)	0.1	0.0	8.1	6.2	10.7	-6.3
Change in NFA. of commercial banks	-16.1	-4.1	42.0	-41.1	0.0	3.6
Sources of financing	**2616.3**	**1071.0**	**1011.3**	**790.9**	**972.8**	**975.3**
Private capital (net)	131.4	98.8	26.6	174.8	140.2	107.3
FDI	29.1	31.7	31.7	220.0	140.0	107.0
Of which: short-term capital errors and ommissions	50.9	0.0	0.0	-0.2	0.2	0.3
Gross official assistance	521.0	581.1	599.5	616.1	832.6	868.0
Official grants	420.1	464.9	503.9	418.8	630.1	623.4
Balance of payments support	72.0	82.8	103.8	101.0	148.0	95.7
Other	348.1	382.2	400.1	317.8	482.2	527.8
Loan disbursements	100.9	116.2	95.7	197.3	202.5	244.6
IMF	14.4	27.6	10.1	95.2	15.9	0.0
Balance of payments support	24.5	9.0	0.0	21.2	55.0	33.0
Project support	62.0	79.6	91.4	80.9	131.6	156.6
Accumulation of arrears (exceptional)	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief (including MDRI)	1963.9	391.1	385.3	0.0	0.0	0.0
Financing gap (surplus+/deficit–)	**-0.7**	**0.0**	**0.0**	**0.0**	**0.0**	**-12.5**
Memorandum items (percent of GDP)						
Gross financing requirements	-82.7	-30.3	-28.2	-18.8	-20.1	-18.5
Current account balance, excluding official transfers	-19.7	-16.3	-16.3	-17.9	-17.2	-17.0
Trade balance on goods and services	-23.5	-21.0	-19.2	-18.8	-15.6	-15.5
Gross official assistance	16.5	16.4	16.7	14.6	17.2	16.3
Gross official assistance, net of amortization after debt relief	15.2	16.2	16.5	14.4	16.9	16.1
Balance of payments assistance (including IMF)	3.5	3.4	3.2	5.2	4.5	2.4
Financing gap	0.0	0.0	0.0	0.0	0.0	-0.2

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

Table 5a: Malawi: Schedule of Disbursements Under the One-Year ESF Arrangement

(SDR Millions)

Amount	Date	Conditions Necessary for Disbursement
34.70	Dec-08	Executive Board approval of one-year ESF arrangement
10.41	Jun-09	Completion of first review and observance of end-Dec. 2008 PCs
6.94	Dec-09	Completion of second review and observance of end-June. 2009 PCs
52.05 [1]		

[1] Equivalent to 75 percent of Malawi's quota (SDR 69.4 million).

Table 5b: Malawi Indicators of Capacity to Repay the Fund, 2007–11

			Projections		
	2007	2008	2009	2010	2011
Fund obligations based on existing credit					
(SDR millions)					
Principal	0.00	0.00	0.00	0.00	0.49
Charges and interest	0.53	0.51	0.41	0.41	0.41
Fund obligations based on existing and prospective credit [1]					
(SDR millions)					
Principal	0.00	0.00	0.00	0.00	0.49
Charges and interest	0.53	0.52	0.63	0.67	0.67
Total obligations based on existing and prospective credit [1]					
in millions SDR	0.53	0.52	0.63	0.67	1.16
In millions of US$	0.8	0.8	1.0	1.0	1.8
In percent of exports of goods and services	0.10	0.08	0.09	0.08	0.15
In percent of debt service	7.2	5.2	4.8	6.1	10.6
In percent of quota	0.8	0.8	0.9	1.0	1.7
In percent of gross international reserves	0.4	0.4	0.3	0.2	0.3
Outstanding Fund credit					
In millions of SDRs	19.6	81.0	98.3	98.3	97.8
In millions of U.S. dollars	30.0	128.4	150.6	150.4	155.1
In percent of exports of goods and services	3.8	12.0	13.3	12.1	12.4
In percent of debt service	264.7	803.1	746.2	888.5	892.9
In percent of quota	28.3	116.6	141.6	141.6	140.9
In percent of gross international reserves	13.8	61.4	43.6	36.5	29.5
Memorandum items:					
Exports of goods and services (millions of US$)	796	1,068	1,133	1,241	1,254
Debt service (US$ million)	11.3	16.0	20.2	16.9	17.4
Quota (SDR millions)	69.4	69.4	69.4	69.4	69.4
Gross international reserves (US$ million)	217	209	345	413	526
GDP (US$ million)	3585	4218	4847	5339	5720

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

1/ Assumes ESF disbursements of SDR 34.7 million in December 2008 and SDR 17.35 during 2009.

Appendix I

Malawi: Letter of Intent

November 13, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. The Government of Malawi requests continued support from the International Monetary Fund for its economic objectives and policy framework for 2008–2009 through a new one-year arrangement under the high-access component of the Exogenous Shocks Facility (ESF). We request access of 75 percent of quota. This arrangement will support our efforts to adjust to the severe terms of trade shock that Malawi is facing, notably as a result of significant increases in fertilizer and fuel prices over the past year. Furthermore, maintaining a close engagement with the Fund will send a positive signal to domestic stakeholders and our development partners, notably concerning our determination to maintain macroeconomic stability and build on the positive results achieved during the recent, successfully completed, arrangement under the Poverty Reduction and Growth Facility.

2. In the attached Memorandum of Economic and Financial Policies (MEFP), we set out our macroeconomic framework and policy objectives for 2008/09 and the medium term. Our over-riding goal is to provide a consistent and coherent economic policy framework to underpin our development objectives while in the near term responding to the terms of trade shock. In that regard, our programme focuses on enhancing the sustainability of growth and development through policies that consolidate economic stability and reinforce resilience to shocks, including through rebuilding of international reserves; improve public finance management; and support private-sector-led growth.

3. The MEFP and Technical Memorandum of Understanding (TMU) present quantitative performance criteria and indicative targets through the period of the arrangement. We believe that the policies set forth in the MEFP are adequate to achieve the objectives of the programme, but we will take additional measures as needed to reach these goals. We will consult with IMF staff on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the agreed IMF policies on such consultation.

4. The Government of Malawi authorizes the IMF to make this letter, the attached MEFP, TMU, and the IMF staff report available to the public, including through the IMF internet website.

Sincerely yours,

/s/
Goodall E. Gondwe, M.P.
Minister of Finance

/s/
Victor Mbewe
Governor
Reserve Bank of Malawi

ATTACHMENT I

Malawi: Memorandum of Economic and Financial Policies of the Government of Malawi for 2008–09

November 13, 2008

I. INTRODUCTION

1. This memorandum summarizes the government of Malawi's economic objectives and policy framework for September 2008–December 2009, for which the Government is seeking continued support from the International Monetary Fund through a new one-year arrangement under the Exogenous Shock Facility (ESF). Malawi is experiencing a serious terms of trade shock caused by higher fuel and fertilizer import prices. We aim to make continued progress with our development goals while responding to the immediate challenge of this shock.

2. **Our program builds on the results achieved during the recent successfully completed PRGF arrangement.** The economic strategy under the PRGF-supported program emphasized the need for reduced domestic borrowing, improvements in revenue performance, and judicious increases in public spending, in order to correct the severe macroeconomic imbalances that existed prior to 2005 and create the space for propoor and progrowth spending. We believe our policy execution during the PRGF arrangement was strong, in sharp contrast to previous arrangements. In the first part of the decade, weak program implementation led to large fiscal slippages, an unsustainable domestic debt spiral, and low investment. Despite numerous attempts to bring the 2000–03 PRGF arrangement back on track, the economy remained in disarray, and the arrangement lapsed after only one review. Since taking office in mid-2004, we have improved economic policies on a broad front.

3. **Our reform program has produced good outcomes.** The strengthening fiscal position since 2005 has supported macroeconomic stability, lower domestic debt and interest rates, and policy credibility. Reflecting these improvements, Malawi has experienced sizable external debt relief and increasing inflows of aid and private capital. Growth has been very strong, averaging 5.8 percent for 2004–07, and in 2007 inflation declined to its lowest level in a decade. Higher revenues and aid and lower interest payments on the public debt have translated into an increase in outlays for poverty-reducing and social expenditures and, with more rapid growth, into progress toward many of the millennium development goals (MDGs).

4. **Public financial management (PFM) reforms have helped us make the most of the increased expenditures.** We have improved PFM through implementation of the broad

agenda described in our PFEM Action Plan. We have strengthened control over the wage bill and utility payments and implemented an Integrated Financial Management Information System (IFMIS) to improve control over expenditures more generally. We have issued a debt management strategy and cleared the 2004 stock of arrears. The most recent Public Finance Management Assessment for Malawi based on the Public Expenditure And Financial Accountability (PEFA), framework concluded that our PFM systems have substantially improved over the past three years and compare favorably to our neighbors.

5. **While recent economic performance has been strong, the serious terms of trade shock has made addressing the remaining development challenges more difficult.** Despite recent progress, poverty remains high and food security is a concern. The economy depends heavily on drought-prone agriculture. Meanwhile, implementing the Malawi Growth and Development Strategy (MGDS) will require increases in public investment and spending in areas such as health and education. In addition, international reserves, fluctuating between 0.7 and 1.4 months of prospective imports, remain uncomfortably low considering Malawi's vulnerabilities. To address these and other challenges while maintaining financial and macro-economic stability, Malawi will continue to need external support.

II. Recent Developments

6. **The economy continues to perform well but has started to feel the impact of higher import prices.** Real GDP growth continues to be strong. The 12-month inflation rate, though increasing recently—mainly as a result of higher food and petroleum prices—remains moderate at 9.3 percent in September 2008. Government net domestic debt was brought down slightly, from 11.9 percent of GDP at the end of 2007 to 11.7 percent at the end of July 2008. Despite the seasonal concentration of tobacco proceeds (April–September), international reserves were only US$175 million (1.1 months of prospective imports) at the end of September 2008.

7. **However, the full impact of much higher fuel and fertilizer import prices has not yet been felt.** One result of the terms of trade shock is a net import bill in 2008 that is US$156 million or 3.8 percent of GDP higher than in 2007, at constant volumes. Meanwhile, higher fertilizer prices have hit the budget directly, raising costs by some KW10 billion relative to the assumptions in the budget.

8. **We have been moving forward with structural reforms.** A public financial management (PFM) unit under the Secretary of Treasury has been established in the Ministry of Finance to promote and coordinate the modernization of PFM systems. In addition, a cash management unit at the Accountant General Office has been formed to enhance the government's capacity for cash flow planning.

9. **We have also tightened control over monetary expansion.** We have mopped up structural excess liquidity through issuance of RBM bonds (MK4.3 billion) and treasury bills (MK4.9 billion) and have managed short-term liquidity more actively. In addition, the scope

of the liquidity reserve requirement has been widened to include the discount houses, effective April 2008. With these operations, interest rates have risen back to levels that help contain inflation in the face of the rise in import prices. Nonetheless, broad money growth remains high: broad money grew by 45.6 percent in the 12-month to August 2008—partly reflecting the effects of output growth on money demand.

10. **The financial soundness of the RBM has been restored.** Operating costs have been reduced, including through staff cuts, and the RBM has been recapitalized and is no longer making losses. The government has converted MK6.5 billion in promissory notes into interest-bearing and tradable treasury notes and transferred another MK23.2 billion in treasury notes (4.3 percent of GDP) to the RBM. Interest costs of MK4.6 billion (0.7 percent of GDP) are reflected in the 2008/09 budget.

11. **We have also made progress in establishing credit reference bureaus, which will over time lower the too-high lending spreads.** Information disclosure clauses have been introduced in commercial bank lending contracts, which should provide the basis for establishing functioning credit bureaus. This should help bring down the cost of lending by lowering the risks and promoting competition among banks through easier identification of sound borrowers.

12. **We have also made progress in improving bank supervision and regulations.** RBM has adopted a risk-based supervision approach to examining bank performance. For the time being the assessment of banks will still be based on CAMEL, with the risk-based assessment run in parallel with CAMEL. Following this change, the RBM will be able to assess more effectively all risks banks undertake in addition to credit risk, as was emphasized in the CAMEL method. Moreover, the RBM continues to assess the quality of bank loans during on-site and off-site examinations. Whenever a bank is found to be under-providing, the RBM directs it to make additional provisions. Related to this, the RBM is revising its Asset Classification Directive to take into account new developments such as International Accounting Standards. RBM, furthermore, has finalized draft amendments to the Banking Act and a Financial Services Bill (FSA) to strengthen the supervisory function of the regulators. The FSA will, in addition, provide for consolidation of supervisory responsibility for the financial sector in a single agency. The amendment to the Banking Act and the FSA are awaiting parliament approval before being passed into law. Finally, the RBM has taken steps to improve its capacity, including examining anti-money-laundering and combating of financing of terrorism–related transactions (training and additional staffing).

13. **Sound governance and good economic performance have helped Malawi to attract considerable international support, both official and private, for investment and development.** Recently Malawi was deemed eligible for support from the Millennium Challenge Account (MCA). Malawi has also witnessed portfolio inflows, although these are now receding, and foreign direct investment (FDI) in the mining sector.

III. Near-term Objectives and strategy

14. **The large negative terms of trade shocks present a major challenge.** Real GDP growth is projected to fall somewhat, to about 6.7 percent in 2009, because growth in maize and tobacco will be more constrained by capacity and possibly higher private sector fertilizer prices. Inflation is likely to come back down, however, as the recent decline in world market fuel price is passed through.

15. **Our near-term objectives and strategy, for which we seek ESF support, aims to provide a consistent and coherent economic policy framework to maintain macroeconomic stability.**

16. **Key policies include:**

- Pursing a monetary and exchange rate policy that keeps inflation moderate and converging gradually toward our medium-term goal of 5 percent. Along with fiscal policy, this should support increasing foreign exchange coverage to give Malawi the resilience to withstand negative shocks that could otherwise derail growth and increase poverty;
- Firmly implementing the 2008/09 budget, which will further reduce government net debt while increasing critical expenditures; and
- Continuing to improve PFM, with a particular focus on monitoring budget execution, expenditure costing, and revenue administration.

17. **We intend to slow monetary expansion in order to contain pressures on inflation and the exchange rate.** Thus, for the remainder of FY2008/09, we will aim at an expansion of broad money that is below nominal GDP growth. Moreover, to improve control over monetary expansion, the program indicative base money targets, as well as the program ceiling on the net domestic assets (NDA) of the RBM, will be set on a monthly average basis for the last month of each quarter. The program ceilings on NDA of the RBM are set out in Table 1.

18. **In the short term, monetary and exchange rate policies will be geared toward keeping inflation moderate and supporting the building of reserves.** Reserve money continues to be the key intermediate target. We also place weight on stabilizing the nominal exchange rate against the U.S. dollar. We believe this has helped signal a commitment to economic stability and anchored inflation expectations and prices of traded goods. However, we realize that over time enhanced exchange rate flexibility is needed. In that regard we are commissioning a study to propose reforms to our foreign exchange rate management that would introduce increased flexibility and ensure alignment with underlying fundamentals, consistent with Malawi-specific circumstances. We will provide adequate foreign exchange to clear the market, while ensuring that over the medium term net purchases are sufficient to

meet the reserve accumulation target. We will take additional measures should clear indications emerge that the program's indicative monthly reserve targets will be missed. Likely measures would include further fiscal or monetary tightening.

19. **The 2008/09 budget passed in September 2008 reflects the Government's intention to maintain fiscal discipline and protect international reserves without crowding out credit to the private sector**. Thus, domestic borrowing is being substantially reduced. The domestic borrowing target in the 2008/09 budget is 1.4 percent of GDP lower than the 2007/08 outcome. However, higher than budgeted prices for fertilizer imports implies increased spending of some MK11 billion, 1.8 percent of GDP. We intend to implement the 2008/09 budget in the face of this shock, aided by stronger than budgeted revenue growth and some expenditure cuts. We look to fill any remaining financing gap through an increase in donor support. We also recognize the uncertainty of other items in the budget and, to keep the budget on track, intend to follow execution closely and take rapid corrective measures when necessary. Prices for ADMARC sales of maize will be structured to avoid losses that could become a fiscal burden. In addition, ADMARC will not borrow further from the RBM. Moreover, because of the need to avoid contingent fiscal liabilities, the National Food Reserve Agency will not engage in commercially oriented trading activities.

20. **Our fiscal policies will keep consolidated domestic debt below 13 percent of GDP, down from 14.5 percent in 2007.** We will not contract or guarantee any external debt on terms below the 35 percent concessional threshold (as set out in the attached Technical Memorandum of Understanding). To ensure that borrowing is consistent with our debt sustainability objectives, we have issued new external debt management guidelines and will continue to strengthen debt management practices.

Structural Reforms to Improve Public Financial and Economic Management

21. **We will take additional measures in the coming months to contain fiscal risks and reinforce public financial management.** We are updating our PFEM Action Plan, originally formulated in 2006, with the support of our development partners and with input from various technical assistance projects. While past initiatives are beginning to show tangible results, it is obvious to us that more work is needed.

22. **Credible budgets are critical to macroeconomic stability and sustainability, and thus remain a priority**. We have strengthened the process of preparing the budget by clarifying the budget calendar and allowing more time for sectoral planning and negotiations; this should help improve the realism of expenditure estimates. We intend to take further measures to enhance budget credibility, such as by

- Improving the quality of tax and nontax revenue projections of the Revenue Division of the Ministry of Finance, supported by the creation of a revenue database.

- Strengthening the capacity of the Ministry of Finance to scrutinize budget submissions. We recognize the need to closely examine both expected expenditure for current programs and activities and the costing of new proposals. We therefore intend to initiate focused reviews of certain sectors—notably road construction—to gain a better understanding of the costs and benefits of various policy options.

23. **We are also taking measures to strengthen budget monitoring and control** by

- Monitoring particularly closely all projects whose total multiyear cost exceeds 1.0 billion Kwacha. Through monthly execution reports, there will be an indication if the budgeted amount will be exceeded, in which case an explanation will be required. By January 2009, we will also prepare a report analyzing the reasons for the budget overruns for Development Part II expenditure in 2007/08.

- Putting in place procedures for taking timely off-setting measures within each vote, and within the competence of the Government, if—based on the regular monitoring of budget execution by the Ministry of Finance—there are indications that there will be an end-of-year overrun. If such measures are not feasible or desirable, a comprehensive supplementary budget will be proposed in accordance with the law.

- Strengthening external audits. We feel confident that the recent approval of a new Auditor General will allow timely submission of audited government accounts to parliament. We also intend to strengthen the capacity of the National Audit Office.

24. **Improved systems for producing timely and accurate budget execution reports are critical for ensuring that spending is contained within the overall envelope.** In that regard, we will continue to produce monthly reports on budget execution based on both funding and IFMIS data, complemented with cash flow data from the RBM. Recognizing the limitations of the current system, we will work to improve the accuracy of these reports by expanding the use of expenditure outturn data from the IFMIS and making more systematic comparisons between different data sources. We see the development of budget execution reports based on actual expenditure reconciled with banking data as being of the highest priority. We intend to

- Prepare two monthly reports on budget execution showing revenue, expenditure, and financing items. The first report will be structured according to votes, with a break-down of Personal Emoluments; Other Recurrent Transfers; Development Part I; and Development Part II spending under each vote. The report will show (1) actual expenditure as recorded in the IFMIS; (2) total funded expenditure; and (3) actual payments as recorded by the RBM. This report will be comparable to the approved budget. The second report will be structured around major economic categories (at the level of detail of the fiscal table). The report will show (1) actual collected revenue; (2) funded expenditure (except for unfunded items); and (3) actual payments for debt service and other unfunded expenditure initiated directly by the RBM, and Development part I expenditure. These reports should be available within two weeks after the end of each month.

- Beginning with the reports for the month of November, we will improve upon these reports by presenting not funding but actual expenditure for all items that are recorded in the general ledger in the IFMIS. The expenditure for Local Assemblies, which are not recorded in the IFMIS, will still be approximated by funding, presented in a separate column. Major differences between funding and actual expenditure as recorded in the IFMIS will be identified and explained.

- Prepare by January 1, 2009, a plan for (1) importing of all expenditure outturn data, including from local assemblies, Part I development spending, and other unfunded expenditures (i.e., debt service payments and other payments initiated by the RBM) into the general ledger in the IFMIS; (2) daily reconciliation of the IFMIS and the payments data from the RBM and the production of budget execution reports based on outturns as recorded in the IFMIS.

25. **We will continue our efforts to bring down the operating costs of the RBM.** To that end we are reviewing minting and printing costs. We have conducted a tender and consulted with neighboring central banks and will work to reduce the cost of printing banknotes. We will further review the cost of minting coins and the bank note structure. These measures, together with staff cuts and the recent recapitalization, will preserve the RBM's sound financial footing.

26. **Further measures to strengthen the financial sector in 2008/09 will draw on the recommendations of the 2007 FSAP.** Near-term priorities are to

- Introduce a mergers and acquisition framework for the banking sector to clarify the conditions under which banks can merge.

- Strengthen the way off-site supervision supports on-site supervision, including through stress testing.

- Continue to improve the functioning of money and foreign exchange markets, making them more efficient and market-oriented. In particular we have eliminated the regulation preventing commercial banks from crossing the mid-rate in the foreign exchange market to ensure enhanced competition among banks and promote reduced spreads in the retail market.

IV. Program Monitoring

27. **The Government believes that the policies set forth in this Memorandum of Economic and Financial Policies are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose.** Malawi will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

28. **Program implementation will be monitored according to quantitative assessment criteria and indicative targets set out in Table 1.** Quantitative performance criteria will be established for end-December 2008 and end-June 2009. The targets for end-March and end-September 2009, and the monthly targets for international reserves will be indicative. The definitions of the variables monitored as quantitative performance criteria are provided in the TMU. Program implementation and the economic results associated with the program will be subject to two reviews with the first review in March 2009 based on end-December 2008 assessment criteria, and the second in September 2009 based on end-June 2009 criteria.

Table 1. Malawi: Quantitative Targets[1]

	Criteria	Jun. 2008 Stock Actual	End-Dec 2008 Proj.	End-Jun 2009 Proj.	End-Dec 2009[6] Proj.
I. Monetary targets (MK millions)					
1. Ceiling on net domestic assets of the monetary authorities[2]	PC	20,177	9,982	5,157	-3,074
2. Ceiling on reserve money	IT	41,340	-738	1,121	1,597
II. Fiscal targets (MK millions)					
3. Ceiling on central government's net domestic borrowing[2 3 4]	PC	93,766	13,313	-804	3,347
III. External targets (US$ Millions)					
4. Floor on net international reserves of the monetary authorities[2, 7]	PC	150.6	-76	-29	33
5. Ceiling on the accumulation of external payments arrears[5]	PC	...	0.0	0.0	0.0
6. Ceiling on new nonconcessional external debt maturing in one year or more[5]	PC	...	0.0	0.0	0.0
7. Ceiling on new nonconcessional external debt maturing in less than one year[5]	PC	...	0.0	0.0	0.0
Memorandum items:					
Balance of payments support (US$ millions)			118.3	211.9	109.4
Balance of payments support (MK millions)			16,632	29,791	15,531
Debt service payments to the WB and the ADB (US$ millions)			2.1	0.6	1.3
Debt service payments to the WB and ADB (MK millions)			300.7	89.7	187.3
IMF debt relief transfers from the RBM to the CG (US$ millions)			0.0	0.0	0.0
IMF debt relief transfers from the RBM to the CG (MK millions)			0.0	0.0	0.0
SWAp receipts			6,384	7,596	11,857
Cash payment of arrears (MK millions)			78	156	298
Securitization of domestic arrears			0	0	0
RBM securitization/capitalization			0	0	0
Liquidity reserve requirement (percent)			15.5	15.5	15.5
Program exchange rate		140.5	140.5	140.5	140.5

Note: PC - performance criteria; IT - indicative target.

1 Targets are defined in the technical memorandum of understanding (TMU). The fiscal targets are set cumulative from the end of the previous fiscal year. Fiscal targets from July 1, 2008 to end-June 2009 are therefore cumulative from end-June 2008.

2 Targets are subject to an adjuster for BOP support as per TMU.

3 Targets are subject to an adjuster for donor-funded health receipts as per TMU.

4 Targets are subject to adjusters for cash payment of arrears as per TMU.

5 Evaluated on a continuous basis.

6 Targets for end-December 2009 are indicative.

7 Monthly indicative gross reserve targets

2008	2008	2009	2009	2009	2009	2009	2009
Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
114	209	162	158	197	202	218	257

ATTACHMENT II

Malawi: Technical Memorandum of Understanding for the Exogenous Shocks Facility (ESF) Arrangement

I. INTRODUCTION

1. This memorandum sets out the understandings between the Malawian authorities and the International Monetary Fund (IMF) regarding the definitions of quantitative and structural performance criteria, benchmarks, and indicative targets for the program supported by the ESF arrangement, as well as the related reporting requirements.

2. **Coverage**: The central government includes all units of government that exercise authority over the entire economic territory. However, in contrast to the System of National Accounts 1993 (SNA 1993) and Government Finance Statistics Manual 2001 (GFSM 2001) standards, nonprofit institutions that are controlled and financed by the central government are excluded for purposes of this memorandum. The accounts of the monetary authorities include those of the Reserve Bank of Malawi (RBM) and the central government's holdings of international reserves. Monetary aggregates under the program are based on the eight-bank monetary survey.

II. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS: DEFINITIONS AND DATA SOURCES

A. Floor on Net International Reserves of the Monetary Authorities

3. **Definition of net international reserves (NIR) of the monetary authorities:** The NIR of the monetary authorities is defined as reserve assets minus reserve liabilities. The values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the cross exchange rates for end-December 2007 for the various currencies and then converted into Kwacha using the U.S. dollar–kwacha exchange rate for year-end 2007.[8]

4. **Gross reserve assets of the monetary authorities** are defined in the International Reserve and Foreign Currency Liquidity Guidelines for a Data Template as external assets immediately available and controlled by RBM "for direct financing of payments imbalances, for indirectly regulating the magnitudes of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes." (*BPM5,* para. 424.).

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[8] Unless otherwise defined, program exchange rates for 2008 between the U.S. dollar and other (non-Kwacha) currencies will be equal to the end-December 2007 rates. Consequently, the U.S. dollar/SDR exchange rate is set at 1.4685. Any other assets (e.g. gold) would be revalued at their end-December 2007 market prices.

5. This concept includes the following: (1) monetary gold holdings of the RBM; (2) holdings of SDRs; (3) the reserve position in the IMF; (4) central government (treasury) holdings with crown agents; and, (5) foreign convertible currency holdings; (6) deposits hold in foreign central banks, the Bank for International Settlements, and other banks; (7) loans to foreign banks redeemable upon demand; (8) foreign securities; and (9) other unpledged convertible liquid claims on nonresidents. Excluded are (1) any foreign currency claims on residents; (2) capital subscriptions in international institutions; (3) foreign assets in nonconvertible currencies; (4) transfers of foreign currency claims to RBM by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates; (5) gross reserves that are in any way encumbered or pledged, including, but not limited to, (i) assets blocked when used as collateral for third party loans and third-party payments, pledged to investors as a condition for investing in domestic securities, and (ii) assets lent by RBM to third parties which are not available prior to maturity, and are not marketable (including the outstanding balance of the loan to Zimbabwe).

6. **Gross reserve liabilities of the monetary authorities** are defined as the sum of the following: (1) outstanding liabilities of the RBM to the IMF; and (2) all short-term foreign currency liabilities of the RBM to nonresidents with an original maturity of up to, and including, one year. Reserve liabilities exclude medium and long-term foreign liabilities.

7. **Adjustment clause on NIR—budget support**: The floor on the NIR of the monetary authorities will be adjusted upward by the full amount by which the cumulative receipts from the budget support are greater than US$30 million above the program baseline (see Table 1). The floor on NIR of the monetary authorities will be adjusted downward by the full amount up to a maximum of US$10 million by which the cumulative receipts from budget support are less than the program baseline. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

8. **Definition of budget support**: Budget support includes all grants and foreign financing that is not directly linked to additional budgetary expenditure. Excluded from this definition is external project financing to fund particular activities, including food security funding from the European Union and loan financing from the IMF, and donor inflows (in Kwacha) from the U.S. dollar–denominated donor pool account for the health sector-wide approach (SWAp) and National AIDS Commission held in the Malawi banking system.

9. **Adjustment clause on NIR—donor pool account for the health SWAp account:** The floor on the NIR of the monetary authorities will be adjusted downward by the full amount by which the donor inflows (in Kwacha) from the U.S. dollar–denominated donor pool account for the health SWAp held in the Malawi banking system is smaller than the donor inflow (in Kwacha) to those accounts in the program baseline. The downward adjustment will be capped at $10 million. Donor inflows for the SWAp account are measured as the receipts received (in Kwacha) by the budget from the SWAp account, a U.S. dollar-

denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

10. **Adjustment clause on NIR—debt service payments**: The floor on NIR of the monetary authorities will be adjusted upward (downward) by the full cumulative amount by which debt service payments to the World Bank and the ADB fall short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year.

11. The total downward adjustment to NIR from a shortfall of (1) budget support and (2) donor inflows to the donor pool account for the health SWAp account relative to program assumptions and (3) an excess of debt service payments relative to the program assumption will be capped at $10 million.

12. For purposes of this target, as well as those for external debt and arrears, valuation will be in U.S. dollars using the above defined program exchange rates.

13. Data on NIR, including its components, will be reported by the RBM on a weekly and end-month basis.

B. Ceiling on the Monthly Average Net Domestic Assets of the Reserve Bank of Malawi

14. **Definition of monthly average net domestic assets (NDA) of the RBM**: NDA of the RBM are defined as the monthly average (based on weekly data[9]) for the final month of each quarter of reserve money less net international reserves at the program exchange rate. Reserve money consists of currency issued by the RBM and balances of commercial banks' accounts with the RBM. It includes required reserves held for Malawi Kwacha deposits and any other domestic currency reservable liabilities and other demand and time deposits held with the RBM. The NDA program ceilings are the indicative money targets defined below (including a symmetrical 1 percent band) less the monthly average (based on weekly data) of net foreign assets (NFA) of the monetary authorities.

15. **Definition of NFA of the monetary authorities:** The NFA of the monetary authorities are defined as the above defined NIR plus other foreign assets of the RBM—including but not limited to (1) capital subscriptions in international institutions; (2) foreign assets in nonconvertible currencies; and (3) gross reserves that are in any way encumbered or pledged, less any medium- and long-term foreign liabilities of the RBM.

16. **Adjustment clause on NDA—budget support**: The ceiling on NDA of the RBM will be adjusted downward by the full amount by which the cumulative flow of receipts from

[9] For months with more than 4 exact weeks, the data for the final few days will be folded into the previous week's data.

budget support are greater than US$30 million above the program baseline. The ceiling on NDA of the RBM will be adjusted upward by the full amount up to a maximum of US$10 million by which the cumulative receipts from the budget support are less than the program baseline. The Kwacha value of the cumulative shortfall/excess will be calculated at the program exchange rate. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

17. **Adjustment clause on NDA—donor pool account for the health SWAp account:** The ceiling on NDA of the RBM will be adjusted upward by the full amount by which the donor inflows (in Kwacha) from the U.S. dollar–denominated donor pool account for the health SWAp held in the Malawi banking system is smaller than the donor inflow (in Kwacha) to those accounts in the program baseline. The upward adjustment will be capped at US$10 million. Donor inflows for the SWAp account are measured as the receipts received (in Kwacha) by the budget from the SWAp account, a U.S. dollar-denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

18. **Adjustment clause on NDA—debt service payments**: The ceiling on NDA of the monetary authorities will be adjusted downward (upward) by the full cumulative amount by which debt service payments to the World Bank and the ADB falls short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year.

19. The total upward adjustment to NDA from a shortfall of (1) budget support and (2) donor inflows to the donor pool account for the health SWAp account relative to the program assumptions and (3) an excess of debt service payments relative to the program assumption will be capped at US$10 million.

20. **Adjustment clause on NDA—liquidity reserve requirement**: The ceiling on NDA of the RBM will be adjusted downward for a decrease in the reserve requirement ratio, and will be adjusted upward for an increase in the ratio. The adjustment will be spread equally over two quarters, starting in the quarter in which the reserve requirement ratio is reduced. The adjuster will be calculated as follows: (one minus the existing required percentage of reserve assets held at the discount houses) multiplied by (the program baseline required reserve ratio minus the new required reserve ratio) multiplied by (the amount of average reservable deposit liabilities in commercial banks during the last month prior to the change in regulation).

21. **Adjustment clause on net domestic assets—debt service payments**: The ceiling on NDA of the RBM will be adjusted downward (upward) by the full cumulative amount by which debt service payments fall short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year. Debt service payments will be converted to Malawi Kwacha using the above defined program exchange rates.

C. Ceiling on Central Government Net Domestic Borrowing

22. **Definition of central government net domestic borrowing (CGDB)**: CGDB is computed as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, government bonds, and holdings of treasury bills minus deposits); (ii) net borrowing from commercial banks[10] (including advances, holdings of local registered stocks, and holdings of treasury bills minus deposits); (iii) net borrowing from nonbanks (including, but not limited to, holdings of local registered stocks and holdings of treasury bills); and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost rather than face value. The ceiling is measured as the change in the stock of CGDB since June 30, 2008, excluding promissory notes and securities transferred to the RBM from the Treasury since the beginning of the fiscal year.

23. **Definition of June 2004 domestic arrears**: June 2004 domestic arrears consist of all domestic arrears for which the obligation to pay was established on or before June 30, 2004.

24. **Definition of domestic arrears**: Domestic arrears are overdue payment obligations of central government other than external payment arrears, including on wages and salaries, pensions, transfers, domestic interest, goods and services, obligations arising from court cases, legally established compensation claims, and tax refunds. Payments on wages and salaries, pensions, transfers, court-established obligations, and compensations are in arrears when they remain unpaid for more than 30 days beyond their due date. Domestic interest payments are in arrears when the payment is not made on the due date. Payments for goods and services are deemed to be in arrears if they have not been made within 90 days of the date of invoice, or—if a grace period has been agreed—within the contractually agreed grace period.

25. **Adjustment clause on CGDB—budget support**: The ceiling on CGDB will be adjusted downward (upward) by the full amount by which cumulative Kwacha receipts from budget support are greater (less) than the program baseline. The upward adjustment will be capped at US$20 million. In the event of excess budget support, the ceiling on CGDB will be adjusted downward by the full amount less US$30 million. The Kwacha value of the cumulative shortfall/excess will be converted at the corresponding monthly average of the RBM mid rate. Cumulative receipts will be measured from the beginning of the fiscal year.

26. **Adjustment clause on CGDB—donor pool account for the health SWAp account:** The ceiling on CGDB will be adjusted upward by the full amount by which the donor inflows (in Kwacha) from the U.S. dollar–denominated donor pool account for the health SWAp held in the Malawi banking system are smaller than the donor inflows

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[10] Includes all commercial banks in Malawi—and in particular the Malawi Savings Bank—not just the banks covered by the eight-bank monetary survey.

(in Kwacha) to those accounts in the program baseline. The upward adjustment will be capped at US$20 million. Donor inflows for the SWAp account are measured as receipts received (in Kwacha) by the budget from the SWAp account, a U.S. dollar-denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

27. **Adjustment clause on CGDB—debt service payments**: The ceiling on CGDB will be adjusted downward (upward) by the full cumulative amount by which debt service payments to the World Bank and the ADB fall short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year.

28. The total upward adjustment to **CGDB** from a shortfall of (1) budget support and (2) donor inflows to the donor pool account for the health SWAp account relative to the program assumptions and (3) an excess of debt service payments relative to the program assumption will be capped at US$30 million.

29. **Adjustment clause on CGDB—securitization of arrears**: The ceiling on CGDB will be adjusted upward by the full cumulative amount by which pre-2005 domestic arrears are securitized from the beginning of the fiscal year.

30. **Adjustment clause on CGDB—cash payment of arrears**: The ceiling on CGDB will be adjusted downward by the full amount by which cumulative payments from June 30, 2008, for verified pre-2005 domestic arrears are less than the program baseline. Only payments that are charged against the Accountant General vote and reported by the Accountant General will be recognized as payments for pre-2005 domestic arrears.

D. Ceiling on External Payments Arrears

31. **Definition of external payment arrears**: External payment arrears consist of debt-service obligations (principal and interest) to nonresidents that have not been paid at the time they are due, as specified in contractual agreements, except on external debt subject to rescheduling or restructuring. A continuous performance criterion applies on the nonaccumulation of external payment arrears on external debt contracted or guaranteed by the central government, the RBM, or other agencies on behalf of the central government or the RBM.

E. Ceiling on Nonconcessional External Debt

32. **Definition of nonconcessional external debt**: The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decisions No. 11096-(95/100), October 25, 1995; and 12274-(00/85) August 24, 2000. For program purposes, short- and medium- and long-term debt is nonconcessional if it includes a grant element of less than 35 percent, as indicated in Decision No. 11248-(96/38), April 15, 1996. The ceiling on nonconcessional debt applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on

behalf of the central government or the RBM on debt with nonresidents. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from the beginning of the fiscal year.

33. **Short-term debt**: Outstanding stock of debt with an original maturity of one year or less.

34. **Medium- and long-term debt**: Outstanding stock of debt with a maturity of more than one year.

35. **Excluded from the limit** is the use of Fund resources, and any Kwacha-denominated treasury bill and local registered stock holdings by nonresidents. Excluded from the limit are also (i) debts classified as international reserve liabilities of the RBM; (ii) new debt issued to restructure, refinance, or repay existing debt up to the amount actually used for the above-mentioned purposes; (iii) normal import financing; and (iv) arrangements to pay over time obligations arising from judicial awards to external creditors. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

III. Quantitative Indicative Targets

A. Ceiling on Reserve Money

36. **Definition of monthly average reserve money**: Reserve money is defined as the monthly average (based on weekly data) of the sum of currency issued by the RBM, including the vault cash of commercial banks, and balances of commercial bank accounts with the RBM. It includes required reserves held for Kwacha deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM. The reserve money targets are the projected averages of June 2008, September 2008, and December 2008, within a symmetrical 1 percent band. The upper bound of the band serves as the indicative target.

IV. Reporting of Certain Transactions in the Fiscal Accounts

37. **Donor pool–funded expenditures in support of the health SWAp**. The Government of Malawi has embarked on an integrated program of service delivery in the health sector, the health sector-wide approach (health SWAp). In support of the health SWAp some donors are pooling resources (the donor pool), and release these resources through normal government procedures (i.e., recurrent budget or development Part II budget) to the health sector. In order to manage the inflows of donor resources a U.S. dollar-denominated account has been set up at the RBM that holds donor pool resources until expenditures need to be financed.

V. Reporting Requirements

38. Monitoring of the program requires that the information listed in Tables 2 and 3 below be reported to the IMF within the timeframe indicated.

Table 2: Reporting Requirements

Data description	Data Freq.	Reporting Agency	Reporting Freq.	Delivery Lag	Delivery Date	Delivery Mode
Gross international reserves, exchange rate, and foreign exchange purchases and sales	D	RBM	W	2	F	E
Reserve money and its components (NDA and NFA), OMO transactions, and RBM conversion of treasury bills	D	RBM	W	2	F	E
Daily exchange rate	D	RBM	W	1	F	E
Treasury bill and RBM bill auction results	W	RBM	W	2	F	E
RBM balance sheet and broad money estimate	W	RBM	W	7	F	E
Backlog of import applications for foreign exchange	W	RBM	W	7	F	E
International Reserve and Foreign Currency Liquidity Data Template	M	RBM	M	30	30	E
Central government domestic borrowing	M	RBM	M	30	30	E
Interest rates	M	RBM	M	30	30	E
Holdings of local registered stocks, treasury bills, and RBM bills	M	RBM	M	30	30	E
Detailed issue and maturity profile for treasury bills and RBM bills	M	RBM	M	30	30	E
Excess reserves by bank	D	RBM	M	30	30	E
Details of project and balance of payment support	M	RBM	M	30	30	E
FCDA holdings	M	RBM	M	30	30	E
RBM foreign exchange Cash flow	M	RBM	M	30	30	E
Foreign exchange exposure limits by bank	M	RBM	M	30	30	E
Bank statements of the Health SWAp account held at the RBM	M	RBM	M	30	30	E
Eight bank monetary survey and full banking survey (on monthly average basis)	M	RBM	M	45	15	E
Financial soundness indicators by banks	Q	RBM	Q	45	T15	E
Insurance company survey	Q	RBM	Q	45	T15	E
NAC consolidated statement of sources and uses of funds (cashflow statement)	M	MOF	M	30	30	E
SWAp statement of sources and uses of funds (as per attached table 2)	M	MOF	M	30	30	E
Fiscal table (GFS) including revenue, expenditure, and financing.	M	MOF	M	30	30	E
Revenue data (from MRA)	M	MOF	M	30	30	E
Monthly expenditure for domestically financed capital projects	M	MOF	M	30	30	E
New external loans contracted or guaranteed by the central government [1]	Q	MOF	Q	30	T30	E
Quarterly external debt service (actual and projections)	Q	MOF	Q	30	T30	E
Borrowing of the ten major parastatals [2]	Q	MOF	Q	45	T15	E
Annual financial reports of the ten major parastatals and MSB	A	MOF	Q	90	Mar. 30	H
Report on IMF program performance	Q	MOF	Q	45	T15	E
Statement on new arrears	Q	AuG	Q	45	T15	E
Consumer price index and monthly statistical bulletin	M	NSO	M	30	30	E
Import and export data	M	NSO	M	45	T15	E
Balance of payments, and quarterly statistical bulletin	Q	NSO	Q	45	T15	E
National accounts, balance of payments, and quarterly statistical bulletin	A	NSO	BA	45	15; Sep.	E

D-Daily, W-Weekly, M-Monthly, Q-Quarterly, BA-Bi-annual A-Annual; F-Friday, 30-Every 30th, T30-Every third 30th; E-Electronic, H-Hard copy

1 Detailed information on the amounts, currencies, terms, and conditions, including debt contracted or guaranteed by the RBM or any other agency on behalf of the central government.

2 Agriculture Development and Marketing Corporation, Air Malawi, Electric Supply Company of Malawi, Malawi Development Corporation, Malawi Housing Corporation, Malawi Postal Corporation, Malawi Telecommunications Ltd., Northern Regional Water Board.

Table 3: SWAp Statement of Sources and Uses of Funds

	monthly data
mln USD	
Opening balance in SWAP forex account	x
Inflows in foreign exchange from donors	x
DFID	x
Norway	x
UNDP	x
Global Funds	x
UNFPA	x
UNICEF	x
Other	x
Closing balance in SWAP forex account	x
Memornadum items:	
Donor funds received through RBM	x
Donor funds received through commercial banks	x
Donor funds spent offshore	x
Government contribution in MwK	x
SWAp expenditure	x
of which: Wages	x
Other Goods and services (ORT)	x
Development expediture	x

INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for Request for a One-Year Exogenous Shocks Facility (ESF) Arrangement

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

Informational Annex

Approved by Robert Corker and Adnan Mazarei

November 19, 2008

- **Relations with the Fund**
- **Joint IMF-World Bank Management Action Plan**
- **Statistical Issues**

CONTENTS PAGE

ANNEXES

MALAWI: RELATIONS WITH THE FUND

(As of September 30, 2008)

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

II. General Resources Account:

	SDR million	Percent Quota
Quota	69.40	100.0
Fund holdings of currency	67.08	96.65
Reserve position in Fund	2.33	3.36

III. SDR Department:

	SDR million	Percent Allocation
Net cumulative allocation	10.98	100.0
Holdings	0.04	0.38

IV. Outstanding Purchases and Loans:

	SDR million	Percent Quota
PRGF arrangements	46.25	66.64

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	8/5/2005	8/4/2008	48.58	48.58
PRGF	12/21/2000	12/20/2004	45.11	12.88
PRGF	10/18/1995	12/16/1999	50.96	50.96

VI. Projected Obligations to Fund[11]

(SDR millions ; based on current use of resources and present SDR holdings):

	Forthcoming				
	2008	2009	2010	2011	2012
Principal				0.49	2.64
Charges/Interest	0.19	0.51	0.51	0.51	0.50
Total	0.19	0.51	0.51	1.00	3.14

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

VII. HIPC Initiative

A. Commitment of HIPC assistance	Enhanced Framework
Decision point date	12/21/00
Assistance committed (NPV terms) [2/]	
Total assistance (US$ million)	1,057.00
Of which: Fund assistance (SDR million)	45.27
Completion point date	9/1/06
B. Delivery of Fund assistance (SDR million)	
Amount disbursed	33.37
Interim assistance	11.57
Completion point balance	21.80
Additional disbursement of interest income [3]	3.82
Total disbursements	37.19

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI)

A.	MDRI-eligible debt (SDR millions)[4]	37.87
	Financed by: MDRI Trust	14.53
	Remaining HIPC resources	23.34

B. Debt Relief by Facility (SDR millions)

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

[2] Because 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, these two amounts cannot be added.

[3] 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 in the interim.

[4] The MDRI provides 100 percent debt relief to member countries that qualify for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover all debt owed to the Fund as of 2004 that remains outstanding at the time the member qualifies for debt relief.

IX. Safeguards Assessments:

Safeguards update of the Reserve Bank of Malawi (RBM) was completed in January 2006 with respect to the PRGF arrangement approved on August 5, 2005. Previous assessments of the RBM were completed in 2001 and 2003. The update found that the RBM had taken steps to strengthen its operations, but new vulnerabilities had emerged, particularly in the areas of governance and financial reporting. Recommendations to mitigate the identified weaknesses included: (i) reconstitution of the RBM board of directors, which was dissolved in August 2005, and subsequent reestablishment of an audit committee; (ii) expansion of explanatory notes in the financial statements to include advances to government and letter of credit financial commitments; and (iii) strengthening of the central bank law provisions on the appointment and dismissal of board members. The 2006 assessment is being updated in the context of the proposed high-access ESF arrangement.

X. Exchange Arrangements:

Since mid 2006, the authorities have kept the exchange rate stable. During the second review of the PRGF arrangement in August 2006 a multiple currency practice (MCP) under Article VIII (as evident by the significant spread between the commercial bank exchange rate and the rates at foreign exchange bureaus) was identified. More recently, a forward commercial bank foreign exchange market has emerged that has at times traded at a depreciated rate. Because emergence of the forward market was not due to any government action, the spreads between the forward market and other segments of exchange market do not represent a modification of the existing MCP or a new MCP. Malawi also maintains restrictions on the capital account. On October 23, 2008, the exchange rate was MK 140.60= US$1.00.

XI. Article IV Consultation:

Malawi is on a 24-month Article IV consultation cycle. The last consultation (CR No. 07/147) was concluded by the Executive Board on March 14, 2007.

XII. **Technical Assistance**:

Date	Duration	Dept.	Recipient	Purpose	Form
9/01	1½ weeks	FAD	Ministry of Finance	Expenditure tracking and fiscal ROSC	Mission
11/01	2 weeks	MAE	RBM	Monetary operations and further developing financial markets	Mission
02/02	2 weeks	FAD	Ministry of Finance	Expenditure policy	Mission
05/02	6 months	FAD	Ministry of Finance	Expenditure management	Advisor
07/02	2 weeks	STA	National Statistical Office (NSO), RBM	GDDS Anglophone project on national accounts statistics	Mission
08/02	2 weeks	STA	RBM	Monetary and financial statistics	Mission
02/03	2 weeks	MAE	RBM	Monetary operations, payments system, banking supervision	Mission
08/03	2 weeks	STA	NSO	GDDS Anglophone project on balance of payments statistics	Mission
09/03	2 weeks	STA	NSO, Ministry of Finance, RBM	ROSC on the quality of macroeconomic data	Mission
02/04	2 weeks	MFD	RBM	Monetary operations, credit quality assessment, payments system, banking supervision	Mission
04/04	2 weeks	STA	RBM	Monetary and financial statistics	Mission
01/05	2 weeks	LEG/MFD	RBM	AML/CFT	Mission
03/05	2 weeks	FAD	Ministry of Finance	Tax Policy Mission	Mission
08/05	1 week	STA	Ministry of Finance	GDDS project on fiscal sector	Mission
11/05	1 week	FAD	Ministry of Finance	Civil service pensions	Mission
12/05	2 weeks	MFD	RBM	Monetary operations, banking supervision, payments systems, and forex bureaus	Mission
02/06	1 week	FAD	Ministry of Finance	Civil service pensions	Mission
03/06	1 week	FAD	Ministry of Finance	PSIA on the Fertilizer Scheme	Mission
05/06	1 week	FAD	Ministry of Finance	Tax regime for mining	Mission
05/06	2 weeks	MFD	RBM	Liquidity Forecasting	Mission
07/06	2 weeks	MFD	RBM	Payments System	Mission
07/06	3 weeks	STA	RBM	Balance of Payments	Mission
10/06	1 week	FAD	Ministry of Finance	Public Financial Management	Mission
10/06	3 weeks	MCM	RBM	Currency Issues	Mission
11/06	2 weeks	MCM	RBM	Liquidity Forecasting	Mission
11/06	2 weeks	MCM	RBM	Central Bank Accounting	Mission
11/06	2 weeks	MCM	RBM	Bank Supervision	Mission
02/07	2 weeks	FAD	Ministry of Finance	Budget process and improving budget preparation	Mission
03/07	2 weeks	FAD	Malawi Revenue Administration (MRA)	Revenue administration	Mission
03/07	2 weeks	MCM	RBM	Foreign exchange bureaus	Mission
03/07	2 weeks	STA	NSO	National accounts and CPI statistics	Mission
04/07	2 weeks	STA	RBM	BoP statistics	Mission
07/07	2 weeks	MCM	RBM	FSAP	Mission
09/07	2 weeks	STA	NSO, Ministry of Finance, RBM	DFID: STE Phase II, GDDS Dissemination	Mission
09/07	2 weeks	STA	Ministry of Finance	Government Finances Statistics	Mission

01/08	2 weeks	MCM	Finance, RBM	Macroeconomic Policy Formulation	Mission Mission
03/08	1 weeks	FAD	Ministry of Finance	Assessment of the TA needs in the area of PFM Reform	
03/08	1 weeks	FAD	Ministry of Finance	Tax and Customs Administration	Mission
03/08	2 weeks	FAD	Ministry of Finance	Revenue Administration Reform	Mission
03/08	2 weeks	MCM	RBM	Foreign Exchange Operations	Mission
04/08	1 weeks		Ministry of Finance	Assess TA requirements of the MOF and draw up a work plan of activities for 2008/09	Mission
05/08	2 weeks	STA	RBM	DFID: Monetary and Financial Statistics	Mission

XIII. Resident Representative:

Mr. A. Maitland MacFarlan, who replaced Mr. Baunsgaard, started his assignment on August 21, 2007.

MALAWI: JOINT IMF-WORLD BANK MANAGEMENT ACTION PLAN

Implementation Matrix

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	A. Mutual information on relevant work programs		
Bank work program in the next 12 months	**Lending**:		
	-Agriculture Development GEF	Nov, 2008	06/24/2008
	-Agriculture Development SIL	Nov, 2008	06/24/2008
	-Malawi Third Social Action Fund APL II	Oct, 2008	06/24/2008
	-Second HIV/AIDs	Sept, 2008	09/15/2008
	-Participatory Development - Nkhotakota GEGM	Nov, 2008	12/15/2008
	-PRSC 2	October 2008	Board Meeting early February 2009
	Analytical and advisory activities:		
	-Infant and Child Study	None	06/02/2008
	-Country Economic Memorandum	August 2008 October 2008	FY 2009
	-Transport Sector Assessment		08/18/08
	-Education Country Status	Dec, 2008	2009
	-Joint Staff Advisory Note (JSAN) on the 1st APR of the MGDS	None	To Board for information, in Mid- September 2008

Joint Management Action Plan–Implementation Matrix (concluded)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
A. Mutual information on relevant work programs			
IMF work program in next 12 months	New ESF Program 1st ESF review and Article IV consultation 2nd ESF review	September 2008 Mach 2009 September 2009	Board meeting Early-December, 2008 Board meeting mid-May 2009 Board meeting Mid-December, 2008
B. Requests for work program inputs			
Fund request to Bank (with summary justification)			
Bank request to Fund (with summary justification)			
C. Agreement on joint products and missions			
Joint products in next 12 months	JSAN on the PRS annual progress report DSA	 IMF 1st ESF review March 2009	To the Boards in Mid-September, 2008 To the Boards mid-May 2009

MALAWI: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance and program monitoring purposes. The data module of the Report on the Observance of Standards and Codes (data ROSC), published February 17, 2005, found that, while the institutional framework for the production of macroeconomic statistics was broadly adequate, there were shortcomings in the scope, accuracy, and reliability of data. More affected areas are: national accounts, government finances statistics, and monetary and financial statistics. A key STA recommendation was to formally assign the responsibility for the compilation of government finance statistics to the Ministry of Finance and responsibility for the compilation of monetary statistics to the Reserve Bank of Malawi (RBM).

2. The authorities are making efforts to improve the quality and timeliness of economic and financial data through participation in the Fund's General Data Dissemination System (GDDS) and the GDDS Project for Anglophone African Countries. Malawi is participating in the GDDS/PRSP and the monetary and financial statistics modules of the project. GDDS metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since December 2002 and most recently updated in February 2007, which need to be updated.

A. Real Sector Statistics

3. The accuracy and reliability of the real sector data (including national accounts, prices, and trade) are affected by inadequate source data and timeliness. STA has recommended remedial actions, including the need for additional resources for the National Statistics Office (NSO). A long-term technical assistance program in the area of national accounts is being provided under a project by Statistics Norway, Specifically:

National accounts

4. The NSO recently revised the national accounts methodology to implement the SNA93 and to better account for the activities in the informal sector. The estimate of 2006 nominal GDP was revised upward by some 40 percent. The revisions include a lower estimated output share of the agricultural sector, resulting in lower estimates of output growth for 2006 and 2007.

Prices

5. A consumer price index (CPI) is available on a timely basis. The CPI is based on the 1997/98 household survey, and data are collected on a monthly basis by regional price collectors. The authorities are in the process of revising the CPI weights using the 2004 Integrated Household Survey.

Trade

6. Preliminary estimates of trade are now available with a lag of two to three months. Trade data are received electronically from six major ports. The adjustment of imports from c.i.f. to f.o.b. prices is not appropriate and there is no reconciliation with data from neighboring countries.

B. Government Finance Statistics

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

- While **tax revenue data** are received in a timely fashion, it is not always possible to reconcile them with deposits in the Malawi Government (MG) Account.

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

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

- Domestically financed **development expenditure** estimates are based on funding released to line ministries, and estimates on externally funded expenditure are based on reported project grants and loans. Owing to differences in timing and financing modalities (e.g., some donors require prefinancing of expenditure before reimbursement), there are substantial differences between the flow of expenses and corresponding financing data. Thus, there are substantial errors in the reporting of capital spending. In addition, many donor projects are still not incorporated in the budget, and hence the corresponding expenditure is not captured in government finance statistics. Some externally funded development expenditures are likely recurrent and reported capital expenditure therefore overstated.

- Data on **expenditure arrears** are likely incomplete, as reporting from the Commitment Control System appears to be only partial, and ministry level data are not consistent from report to report.

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

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

8. The authorities have received significant technical assistance from the Fund and other donors to strengthen expenditure monitoring and reporting, accounting, and statistical reporting, but results have lagged. The government has pledged to strengthen public financial management and fiscal reporting, and renewed efforts are being made to establish a work plan, including utilizing donor technical assistance more effectively.

9. Government finance data are not reported for publication in the *Government Finance Statistics Yearbook (GFSY)* or the *International Financial Statistics (IFS)*. An August 2005 and August 2007 STA mission that visited Lilongwe reiterated the importance of continued efforts to implement the Integrated Financial Management Information System (IFMIS), and encouraged the authorities to improve the coverage and sectorization of government financial operations and to correctly classify transactions according to international guidelines. The mission proposed, and discussed with the authorities, a migration plan and timetable to adopt the *GFSM 2001* methodology.

C. Monetary and Financial Statistics

10. Despite recent improvements, monetary and financial statistics (MFS) continue to be affected by shortcomings. These includes irregularly reporting to STA[12], lack of proper legislation to granted the authority to the RBM to require reporting from other institutions[13]; the sectorization of the domestic economy, and classification of financial instruments to ensure that the RBM adheres fully to the methodology of the *Monetary and Financial Statistics Manual*. The STA April-May 2004 and May 2008 missions have noted and made recommendation for for addressing each of the above shortcomings.Also, the May 2008 mission assisted RBM staff in developing the standardized report forms (SRFs) for the central bank accounts and monetary aggregates and initiated work on the SRF for reporting the data of other depository corporations (ODCs). The mission also updated the SRF on monetary aggregates with the national definitions of money, and used the central bank data to initiate the development of an integrated monetary database (IMD) that will become effective

[12] The latest monetary data which were reported in May 2008, include observations for March 2008.

[13] Pending legislation would give this authority to the RBM.

only when the RBM reports data on the SRFs for the ODCs and other financial corporations. The mission revised the coverage of interest rates in *International Financial Statistics* to ensure that the most representative rates are published.

D. External Sector Statistics

Concepts and definitions used to compile the balance of payments statistics are in broad conformity with the guidelines presented in the fourth edition of the *Balance of Payments Manual* (*BPM4),* although there has been some progress in the transition to the methodology of *BPM5*. Following a number of technical assistance missions, compilers have introduced some new data sources and have revised several components of the balance of payments. No international investment position statement is prepared.

MALAWI: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(AS OF AUGUST 18, 2008)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	03/08	5/12/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	04/08	5/28/08	M	M	M		
Reserve/Base Money	03/08	5/12/08	M	M	M	LO, LO, LO, LO	LO, O, O, O, O
Broad Money	03/08	5/12/08	M	M	M		
Central Bank Balance Sheet	03/08	5/12/08	M	M	M		
Consolidated Balance Sheet of the Banking System	03/08	5/12/08	M	M	M		
Interest Rates[2]	03/08	5/12/08	M	M	M		
Consumer Price Index	07/08	9/8/08	M	M	M	O, LO, O, O	LO, LO, LNO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA	NA	NA	NA	NA	LO, LNO, LNO, LO	LNO, O, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	09/07	10/31/07	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	09/07	10/31/07	M	M	M		
External Current Account Balance	2006	04/07	A	Q	A	LO, LO, LNO, LO	LNO, LNO, LO, LO, LO
Exports and Imports of Goods and Services	2006	06/07	A	A	A		
GDP/GNP	2006	06/07	A	A	A	LO, LO, LNO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	12/05	05/06	M	NA	NA		
International Investment Position[6]	NA	NA	NA	NA	Na		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on December 2004 and based on the findings of the mission that took place during August 12–28, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[9] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment, and revision studies.

Press Release No. 08/309
FOR IMMEDIATE RELEASE
December 3, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$77.1 Million Exogenous Shocks Facility Arrangement for Malawi

The Executive Board of the International Monetary Fund (IMF) has approved a one-year, SDR 52.05 million (about US$77.1 million) arrangement under the Exogenous Shocks Facility (ESF) for Malawi, to support the authorities in their adjustment to the terms of trade shock caused by rapid increases in fuel and fertilizer prices in the first part of 2008. The decision will enable Malawi to draw an amount equivalent to SDR 34.7 million (about US$51.4 million) from the IMF immediately.

This is the first ESF-supported program to be approved by the IMF's Executive Board. In September 2008, the Executive Board approved modifications to the ESF which provided for faster and higher access, made the facility easier to use, and enhanced its flexibility. These modifications took effect in late November following the receipt of all the necessary legal consents.

Following the Executive Board's discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"Malawi's economic performance has been strong in recent years. Economic growth has been robust, inflation has been moderate, and debt sustainability has substantially improved.

"High world oil and fertilizer prices earlier in the year are putting pressure on inflation and foreign exchange reserves. Recent declines in the price of fuel and fertilizer should help over the medium term, but the negative effects of the earlier price hikes will persist over the next few months, because current imports of oil and fertilizers were contracted at earlier high prices. In this light, Malawi's current low level of international reserves is a concern for financial stability and food security.

"The economic program to be supported by high-level access to IMF resources under the Exogenous Shocks Facility will help to contain the pressure on the balance of payments and rebuild external reserves. Financing will be complemented by fiscal and monetary tightening. Additional donor support has been forthcoming, and will be critical to facilitate the economy's adjustment to the terms of trade shock.

"The government's planned reduction in domestic borrowing in 2008/09 is a key element of the fiscal adjustment. To this end, it will be important to enhance fiscal discipline, including through further improvements in public financial management. Spending pressures will need to be resisted, particularly in the run-up to the May 2009 general elections, in order to safeguard foreign exchange reserves and priority investments," Mr. Kato said.

Recent Economic Developments

Over the last three years, Malawi's economy has experienced high real GDP growth and moderate, but recently rising, inflation. Consumer prices increased by 9.3 percent in the 12 months to September 2008, largely because of a 25 percent increase in fuel prices in June 2008. Food price inflation continues to be subdued, although domestic maize prices reportedly increased sharply in some areas in the first half of 2008.

Malawi's terms of trade deteriorated significantly in 2008, despite solid increase in tobacco export prices and the recent easing of world oil prices. Significantly higher world prices of oil, fertilizers, and other imported goods for most of 2008 adversely affected Malawi's trade balance. In 2008 the net impact on the trade balance from this worsening of Malawi's terms of trade could amount to US$156 million. Recent declines in the price of fuel and fertilizer should help over the medium term, but the negative effects of the earlier price hikes will persist over the next few months, because current imports of oil and fertilizers were contracted at earlier high prices. Although international reserves have been temporarily buttressed by the seasonal concentration of tobacco proceeds in April-September, gross reserves at the end of September 2008 were only US$175 million, corresponding to 1.1 months of imports.

A tight budget for the fiscal year 2008/09 has been approved despite significant political hurdles. Targeted domestic debt repayment in 2008/09 is 0.1 percent of GDP, compared with borrowing of 1.3 percent of GDP in 2007/08.

Monetary policy has brought short-term interest rates up to levels more consistent with medium-term inflation objectives and the reserve situation.

The government continues to place substantial weight on stabilizing the nominal exchange rate against the U.S. dollar, which has held steady since May 2006.

Program Summary

The government's program is designed to support continuing financial and macroeconomic stability, growth, and poverty reduction. During the ESF arrangement the main focus will be on adjusting to the terms-of-trade shock and rebuilding Malawi's reserve buffer while preserving medium-term momentum on growth and poverty reduction. The government aims to achieve these goals through a combination of restrained domestic demand and increased external support. At the same time, it is preparing a medium-term program to reform the money and foreign exchange markets and modernize the monetary policy framework.

Improving public financial management is crucial for ensuring financial stability, rebuilding international reserves, and achieving the goals set out in the Malawi Growth and Development Strategy (MGDS).

Malawi: Selected Economic Indicators 2006/07–20010/11

	2006/07 Act.	2007/08 Prel.	2008/09 Proj.	2009/10 Proj.	2010/11 Proj.
National accounts and prices					
GDP at constant market prices	7.7	8.7	7.6	6.9	6.1
Nominal GDP (MK billions)	466.1	547.3	638.0	731.7	826.5
Nominal GDP per capita (US$)	252.8	288.5	329.0	363.8	385.4
GDP deflator	14.6	8.0	8.3	7.3	6.5
Consumer prices end of period)	7.6	8.5	8.5	6.6	6.4
Food	6.8	6.5	7.3	6.0	6.2
Nonfood	8.6	10.7	9.7	7.1	6.7
Consumer prices (annual average)	10.0	7.7	8.4	7.0	6.6
Investment and savings (percent of GDP)					
National savings	21.7	21.5	18.6	19.8	18.0
Government	10.3	8.9	5.0	8.3	7.3
Private	11.4	12.6	13.6	11.5	10.7
Gross investment	24.4	26.9	24.5	24.6	23.3
Government	11.5	11.7	8.7	10.8	9.7
Private	12.9	15.2	15.9	13.8	13.5
Saving-investment balance	-2.7	-5.3	-6.0	-4.8	-5.3
Government	-1.2	-2.7	-3.7	-2.5	-2.5
Private	-1.5	-2.6	-2.3	-2.3	-2.8
Central government (percent of GDP)					
Revenue (excluding grants)	18.1	19.2	19.4	19.5	20.0
Grants	13.6	10.9	13.2	12.2	12.7
Expenditure and net lending	33.0	32.8	36.2	34.2	35.1
Overall balance (excluding grants)	-14.9	-13.6	-16.9	-14.7	-15.2
Overall balance	-1.3	-2.7	-3.7	-2.5	-2.5
Foreign financing	0.8	1.4	3.8	3.5	3.6
Domestic financing	0.5	1.3	-0.1	-1.0	-1.1
Money and credit (contribution to M2 growth)					
Money and quasi money	24.7	41.3	9.5	13.7	13.4
Net foreign assets	19.7	-2.6	-4.1	11.0	12.9
Net domestic assets	5.0	43.9	13.6	2.7	0.6
Credit to the government	-9.8	51.2	0.9	0.5	-5.2
Credit to the rest of the economy	18.9	22.3	13.1	9.0	10.8
Velocity	5.1	4.3	4.6	4.7	4.6
Money and credit (percent change)					
Money and quasi money	24.7	41.3	9.5	13.7	13.4
Net foreign assets	91.4	-7.8	-18.9	68.9	54.2
Net domestic assets	6.3	65.7	17.3	3.2	0.8
Credit to the government	-29.2	101.5	3.2	1.8	-22.7
Credit to the rest of the economy	46.8	46.8	26.5	15.8	18.6
External sector (millions of US$)					
Exports, f.o.b.	610.0	829.4	1,030.6	1,104.2	1,175.4
Imports, c.i.f.	-1,140.7	-1,274.4	-1,447.5	-1,536.8	-1,673.1
Usable gross official reserves	181.3	202.6	256.5	371.2	505.0
(months of imports)	1.2	1.3	1.5	2.0	2.6
Current account	-2.7	-5.3	-6.0	-4.8	-5.3
Current account (excluding official transfers)	-16.4	-17.2	-17.5	-17.1	-17.0
Nominal effective exchange rate	-2.6	-1.4	...	...	...
Real effective exchange rate	0.8	-1.2	...	...	...
Domestic debt (percent of GDP)					
Net domestic debt (central government)	12.2	17.1	14.6	11.7	9.3
Of which: excluding recapitalization of RBM	12.2	11.7	9.9	7.7	5.7
Net consolidated domestic debt (central bank and central government)	14.6	11.6	7.8	6.4	5.9
Domestic interest payment	3.1	2.1	2.6	2.1	1.6
Treasury bill rate (period average)	20.9	10.1	...	...	...

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

Statement by Samuel Itam, Executive Director for Malawi
December 3, 2008

Malawi has been buffeted by a serious terms of trade shock emanating from high, albeit subsiding, fuel and fertilizer input prices. The Malawi authorities are requesting a one-year high-access ESF arrangement to help the country cope with the shock. The recent adverse terms of trade shock is occurring against a background of an impressive economic performance over the course of the last three years under a PRGF supported program.

Recent economic developments

Malawi has undergone an extraordinary transformation since it implemented the PRGF, reversing the dire situation that prevailed three years ago. Economic growth has been robust and broad based and macroeconomic stability has been restored. Growth, which averaged 5.8 percent a year during 2004-07, is projected at 8.7 percent and 6.7 percent in 2008 and 2009, respectively. The recorded strong GDP growth is supported by robust performance of the agricultural sector, construction, manufacturing and services.

Despite the recent increases as a result of higher food and petroleum prices, year-on-year inflation rate remains moderate at 9.3 percent in September 2008. Furthermore, it is expected that the moderation of oil prices, availability of adequate food supplies, stabilization of grain prices, and ongoing monetary restraint will bring inflation down to 7-8 percent.

Overall fiscal performance continues to improve, reflecting higher revenue mobilization and better expenditure control. Government net domestic debt has been on a declining trend and the authorities have managed to eliminate domestic arrears which have been a cause for concern in the past. The authorities have also been moving forward with other structural reforms, particularly regarding expenditure monitoring and control. International reserves stood at 1.1 months of prospective imports, boosted by growth in export volume and prices. With the full impact of higher fuel and fertilizer prices however, international reserves have declined to precarious levels in recent months.

The authorities have continued to tighten control over monetary expansion and to mop up the structural excess liquidity through issuance of RBM bonds and treasury bills and have managed short-term liquidity more actively. The financial health of the RBM has been restored through recapitalization and improvements in operating costs. Progress has also been made in the establishment of credit reference bureaus. Bank supervision and regulation is improving through enhanced on-site and off-site examinations. The Banking Bill and Financial Services Bill (FSA) aimed at strengthening the supervisory function of the regulators are awaiting parliamentary approval.

However, despite this broad range of achievements, the authorities still face formidable challenges in maintaining high and stable growth, developing infrastructure, and achieving the Millennium Development Goals. This is made more difficult by the current distress in global economic and financial environment and complex domestic political climate, and the vulnerabilities to exogenous and natural shocks.

As staff have rightly noted, Malawi is one of the African countries worst hit by the recent food and fuel price increases. The terms of trade shock has resulted in a net import bill of US$156 million or 3.8 percentage points of GDP higher than last year. In addition to the risk to the balance of payments position, the higher fertilizer prices have hit the 2008/09 budget directly, raising costs by some MK10 billion, creating a gap of about US$75 million dollars relative to the budgeted amount. The country is not immune from the ramifications of the unfolding global economic and financial turmoil. On the other hand, the country's successful focus on food security initiatives has protected it to a certain extent from the harsh impact of the food shortages and price increases.

Faced with these mounting challenges, the government has refocused it's near term objective to address the emerging problems and has formulated an interim program with the support of staff. The objectives of this program are to mitigate the adverse impact of the exogenous shocks, and sustain macroeconomic stability and the buoyancy in growth. The main elements of the government's program are ensuring fiscal discipline, enhancing resilience to external and natural shocks and sustaining the ongoing reform effort. This program is expected to provide space for reflection and assessment as the authorities formulate their next post election medium term program.

The authorities have adopted and are implementing a coherent set of fiscal, monetary and structural measures to achieve the objectives of the program. The balance of payments support under the ESF will help mitigate the impact of the shocks and assist Malawi in meeting its objective of raising international reserves in the medium term.

Fiscal policy

The authorities are determined to maintain their prudent fiscal policy stance particularly in light of the fiscal gap that has emerged as a result of the significant increase in fertilizer prices and the anticipated expenditure pressures in an election year. They intend to maintain fiscal discipline, and thus build international reserves without crowding out credit to the private sector. They believe that consolidating domestic debt below 13 percent of GDP, down from 14.5 percent in 2007, is consistent with the program objective.

Although the higher-than-budgeted prices for fertilizer imports have increased spending, cutting back on fertilizer imports is not a viable option given its critical importance in the food security strategy. Consequently it is expected that the increased outlay will be covered by compensatory cutbacks in budgetary expenditure, higher domestic revenue mobilization and additional external support. Moreover the authorities recognize the uncertainty of other items in the budget and intend to follow execution closely to adjust policies in a timely manner. They have also taken steps to avoid contingent fiscal liabilities arising from the temporary administrative measures in agricultural marketing. Finally, the authorities have identified the critical missing links in their Public Financial Management program and are addressing them. They have discussed and prioritized their TA needs in this area and are constantly evaluating progress.

Monetary and exchange rate policies

The authorities are committed to a framework that will maintain macroeconomic stability through anchoring inflation and its expectation. To this end, they have been tightening monetary policy which has led to a significant increase in interest rates. They intend to aim for a restrained expansion of broad money for the reminder of FY 2008/09. They also intend to take action as needed to support the building up of reserves, particularly in light of their precariously low levels and projected decline in the near-term.

The authorities continue to place weight on stabilizing the nominal exchange rate against the U.S. dollar as it has underpinned economic stability and anchored inflation expectations and prices of traded goods. They, however, see the need for greater flexibility over time.

Going forward, my authorities are planning to strengthen the financial sector and minimize spillovers from global economic and financial crises by strengthening the stress-testing framework to support on-site and off-site supervision; allowing mergers and acquisitions; enhancing the interbank money and foreign exchange markets; promoting efficient financial intermediation; and implementing elements outlined in the recent FSAP.

Conclusion

The Malawi authorities have, over the last several years, shown their unwavering commitment to sound economic management. The shock to the economy is exogenous, of a "sudden" nature and temporary, and has created a balance of payments financing need. Malawi has satisfied all the criteria for accessing the reformed ESF. These include the submission of an appropriate policy commitment letter and reform program being on-track. Therefore, my authorities call for the approval of their request for a one-year high access ESF arrangement.

My authorities would like to express their deep appreciation to Executive Directors, Fund Management and staff, and also to Malawi's development partners, for their continued proactive engagement and support to transform the economy and strengthen its resilience to shocks, achieve macroeconomic and financial stability, sustain high growth and reduce poverty.