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REPUBLIC OF MADAGASCAR

November 2015

STAFF-MONITORED PROGRAM AND REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF MADAGASCAR

In the context of the Staff-Monitored Program and Request for Disbursement Under the Rapid Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 18, 2015, following discussions that ended on September 23, 2015, with the officials of the Republic of Madagascar on economic developments and policies underpinning the IMF disbursement under the Rapid Credit Facility. Based on information available at the time of these discussions, the staff report was completed on November 4, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Staff Representative** on the Republic of Madagascar.
- A **Statement by the Executive Director** for the Republic of Madagascar.

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

Letter of Intent sent to the IMF by the authorities of the Republic of Madagascar*
Memorandum of Economic and Financial Policies by the authorities of the Republic of Madagascar*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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November 18, 2015

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IMF Executive Board Approves US$42.1 Million Disbursement Under the Rapid Credit Facility for Madagascar

On November 18, 2015, the Executive Board of the International Monetary Fund (IMF) approved a SDR 30.55 million (about US$42.1million) disbursement in financial assistance for Madagascar under the Rapid Credit Facility (RCF)[1]. This is intended to assist the authorities to meet urgent balance of payments needs. The authorities' request follows a first RCF disbursement of an equivalent amount—SDR30.55 million (about US$42.1million)—approved by the Executive Board on June 18, 2014 (see Press Release No. 14/287).

The Executive Board was also informed about the Managing Director's approval of a six-month Staff-Monitored Program (SMP) covering the period up to the end of March 2016. The SMP is intended to guide policy implementation, further develop local capacity, and build a stronger track record. A demonstrated capability to sustain reforms is a prerequisite for a future request for an arrangement under the Extended Credit Facility (ECF). The SMP in combination with the RCF disbursement are also expected to catalyze external financial assistance in 2015 and 2016.

The economic environment remains challenging. The recovery that began in 2014 has failed to gain further momentum due to falling commodity prices, weather-related shocks, and deep-rooted structural weaknesses. Against this background, private investment has also remained weak. Growth is expected to reach 3.2 percent in 2015, with end-year inflation contained at 7.9 percent.

Despite the challenges facing Madagascar, macroeconomic policies have generally succeeded in maintaining economic stability and sustainability in 2015. Going forward, the authorities have

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[1] The RCF (http://www.imf.org/external/np/exr/facts/rcf.htm) provides immediate financial assistance with limited conditionality to low-income countries with an urgent balance of payments need. In this context, the economic policies of a member receiving RCF financing are expected to address the underlying balance of payments difficulties and support policy objectives including macroeconomic stability and poverty reduction. Financing under the RCF carries a zero interest rate, has a grace period of 5.5 years, and a final maturity of 10 years. The Fund reviews the level of interest rates for all concessional facilities every two years.

begun implementing significant measures aiming to further strengthen macroeconomic stability, particularly to improve revenue generation, enhance the quality of fiscal spending, strengthen central bank operations, and improve the functioning of the foreign exchange market. The ultimate policy objective is to scale up spending on essential infrastructure and social development to secure strong, sustainable, pro-poor growth that reverses the deterioration in development indicators. The government has also adopted a new strategy to fight corruption and improve governance.

New measures to improve tax administration focus on increasing compliance, deterring fraud, eliminating some exemptions, and tackling the large informal sector. To enhance the quality of expenditures, the authorities will eliminate inefficient fuel subsidies and reduce the need for transfers to loss-making state-owned enterprises, including the energy company JIRAMA and Air Madagascar. The authorities will also take actions to avoid the build-up of new domestic arrears and settle the existing stock expeditiously. The ongoing recapitalization of the central bank, revision of its legal framework, and more active bank liquidity management will reinforce the capacity to safeguard price and financial sector stability.

Following the Executive Board discussion on Madagascar's new RCF request, Mr. Furusawa, Deputy Managing Director and Acting Chair stated:

"Madagascar's economic recovery has been slower than expected as a result of falling world prices for commodity exports, weather-related shocks, and deep-rooted structural problems. Against this background, financing and balance of payments needs have grown. Nonetheless, the authorities' policies over the past six months have succeeded in broadly preserving macroeconomic stability and debt sustainability. The disbursement under the Fund's Rapid Credit Facility should help catalyze donor support.

"The government aims to raise growth and reduce poverty on a sustained basis. This will require higher public investment in physical, human, and institutional capital. Efforts to create the necessary fiscal space focus on raising the currently low level of revenue collection, combined with better spending prioritization. Stronger economic governance, including a strategy against corruption, is needed to enhance the efficiency of the public sector and improve the business climate, thereby promoting private sector-led growth. The authorities are committed to avoiding a build-up of new domestic arrears and to clearing the existing stock expeditiously. The draft 2016 budget includes welcome policy initiatives in these directions. Sustained reform efforts will be necessary to support medium-term development and mobilize additional external financing.

"The Malagasy authorities have taken steps to enhance the functioning of the foreign exchange market, maintain a flexible exchange rate, and strengthen the central bank's capacity and independence. Additional measures, including more active liquidity management, should aim to deepen the financial sector and strengthen price and financial sector stability."

REPUBLIC OF MADAGASCAR

November 4, 2015

STAFF-MONITORED PROGRAM AND REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY

EXECUTIVE SUMMARY

Background. Madagascar's economic recovery has failed to gain momentum in 2015, due largely to external shocks, persistent political instability, and weak governance. Nonetheless, the authorities have implemented an adequate policy mix that has broadly maintained macroeconomic stability. However, current growth and investment outcomes are not sufficient to make significant progress in improving social conditions, and increased revenue and external financing are needed to meet large infrastructure and social needs. Balance of payments needs remain both urgent and protracted.

Request. Based on the track record of policies over the past six months, the authorities are requesting a second disbursement under the RCF of SDR 30.55 million, or 25 percent of quota, to meet balance of payments needs. This request follows a first RCF disbursement in June 2014. In addition, a staff-monitored program (SMP) running from September 2015 to March 2016 will help guide policy implementation and establish a stronger track record that could support a medium-term economic program and an eventual request for an Extended Credit Facility (ECF) arrangement. The Financial Sector Assessment Program (FSAP) underway will also guide future Fund engagement.

Main policy commitments. The authorities have unified the official exchange rate with the market rate by discontinuing buyback transactions that had influenced the official rate. The authorities are also undertaking reforms to increase revenue generation, improve the quality of spending (including reforming public enterprises), and strengthen central bank capacity. The draft 2016 budget submitted to parliament is anchored by credible revenue and expenditure measures to support development priorities while reducing financing needs.

Staff's view. Staff supports the authorities' request. The package of measures articulated in the attached letter of intent represents a considerable effort. The RCF disbursement in combination with the SMP would supplement the authorities' own strong policy efforts, help catalyze additional donor financing, and assist the authorities in building capacity and a track record that would support a medium-term program.

Approved By
David Owen and Chris Lane

A staff team consisting of Messrs. Mills (head), Engstrom, and Matz (all AFR), Ms. Muthoora (FAD), and Mr. Pienkowski (SPR) visited Antananarivo during September 9-23. The mission was assisted by Mr. Imam (resident representative) and Ms. Rasoamanana (local economist). The mission met with President Rajaonarimampianina, Prime Minister Ravelonarivo, Minister of Finance and Budget Rakotoarimanana, Minister of Economy and Planning Raveloharison, Central Bank Governor Rasolofondraibe, Economic Advisor to the President Rajaobelina, and other senior government officials, as well as representatives of the private sector, civil society, and development partners. Mr. Ismael (OED) and World Bank staff participated in the discussions.

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BACKGROUND AND CONTEXT

1. **Madagascar's economic recovery has failed to gain momentum, due to external shocks, persistent political instability, and weak governance**. This disappointing outcome since the re-establishment of constitutional democracy in 2014 continues a pattern over the last fifty years. Projected real growth in 2015 is around 3 percent, roughly the same as 2014 and equivalent to population growth. As a result, per capita GDP has stagnated, amid already widespread poverty (Figure 1).[1] The economic, social, and institutional costs of the political crisis in 2009-13 were profound—per capita incomes fell, social indicators worsened, and measures of governance, the rule of law, and public sector efficiency deteriorated sharply (Figure 2). Political consensus has proven elusive since 2014, with conflicts among the executive, legislative, and judicial branches[2] hamstringing implementation of key reforms.[3] Local elections were held in July 2015, opening the way for the formation of the Senate and other institutions.

2. **Despite these difficulties, macroeconomic policies in 2015 have generally succeeded in maintaining stability and sustainability.** Notwithstanding exogenous shocks and sluggish growth, inflation has remained in single digits and the import coverage of international reserves is projected to rise somewhat. Fiscal and current account deficits also remain compatible with medium-term sustainability. The authorities have also begun implementing significant measures aiming to strengthen stability and sustainability, particularly to improve revenue generation, the quality of fiscal spending, central bank operations, and the functioning of the foreign exchange market. In June 2015, the Malagasy authorities finalized implementation plans for the National Development Plan (NDP), which aims to significantly increase spending on infrastructure and social development to support strong, sustainable, pro-poor growth. Meeting these needs both requires an improvement in persistently low revenue collection and gives rise to a protracted balance of payments need.

3. **In light of urgent balance of payments needs the Malagasy authorities are requesting a second disbursement under the Rapid Credit Facility (RCF), accompanied by a Staff-Monitored Program (SMP).** Madagascar faces a balance of payments financing gap and a low level of international reserves. The requested RCF disbursement will help to fill this gap, as well as catalyze much needed donor support in 2015 and 2016; in the absence of this support, financing shortfalls for both the balance of payments and the budget would prove highly disruptive to external and internal stability. This request follows a previous RCF disbursement in June 2014. Outcomes fell short of the ambitious targets initially set in 2014, however, highlighting the deep-

[1] Per capita income in US dollar terms has fallen an estimated 13 percent between end-2013 and end-2015, due to the depreciation of the currency.

[2] For example, in May 2015, the National Assembly voted to impeach the President but the High Constitutional Court rejected the legal grounds for the impeachment in June. In July 2015, the National Assembly fell just short of the two-thirds majority needed to remove the Prime Minister and cabinet.

[3] For example, it was not possible to enact high priority legislation to combat the illegal trade in rosewood.

rooted challenges in a fragile country like Madagascar. Nevertheless, the track record of economic policies over the past six months has been adequate to maintain stability and sustainability (see Economic Developments and Policy Performance below), which forms the basis for the request for a second RCF disbursement. At the same time, in light of the outcomes in 2014 and 2015, the Malagasy authorities have not yet sufficiently demonstrated the capacity to strengthen economic policies significantly and ensure adequate financing. This capacity is necessary to implement a medium-term economic program successfully, which in turn could be supported by an arrangement under the Extended Credit Facility (ECF). The SMP, which covers the period from September 2015 to end-March 2016, is intended to guide policy implementation, further develop policy implementation capacity, and build a stronger track record. The RCF and SMP are expected to have a catalytic effect on bilateral and multilateral financial assistance in 2015 and 2016.

ECONOMIC DEVELOPMENTS AND POLICY PERFORMANCE

A. Real economy and external sector

4. The modest economic recovery that began in 2014 has failed to gain momentum in 2015. Growth projections for 2015 have been revised down to 3.2 percent, compared to 3.3 percent in 2014. External shocks (falling commodity prices, cyclones, and droughts) have hit the mining and agriculture sectors. Power outages by the electricity company have also held back output, while problems at Air Madagascar—including a month-long strike in July that grounded nearly all flights—have hurt the tourism sector. Private investment has remained restrained by structural problems, the weak business climate and political uncertainty, rather than rebounding as hoped following the end of international isolation. Consumer price inflation has risen slightly from 6 percent year-on-year (yoy) in December 2014 to 7.5 percent in September 2015, driven particularly by higher prices for rice and for charcoal, the principal energy source for most households.

5. After declining significantly in 2014, the current account deficit is widening modestly in 2015. Last year, the current account deficit fell to 0.2 percent of GDP as a result of falling fuel prices and a shift in large mining projects from investment to exports. The deficit is expected to grow in 2015, driven by low tourism receipts, an increase in dividend outflows, and lower budget support grants. Meeting Madagascar's large infrastructure investment needs will require more imported inputs, financed externally, and as a result, deficits should grow over the medium term (Figure 3).

6. Pressures in the foreign exchange market have increased. At end-August, the market exchange rate used for private sector transactions had depreciated 10.5 percent (yoy) in nominal effective terms. In early September, the central bank discontinued buyback operations in the foreign exchange market, which had artificially maintained the published official rate at a more appreciated level.[4] To ease the resulting transition, the central bank enacted a temporary 100 percent surrender requirement for exporters in August and sold around US$18 million in foreign exchange in early-September; the market exchange rate has remained roughly stable. International reserves are projected to rise slightly this year, but at about 2½ months of import coverage, they remain below the optimal level (about 3½ months according to the last Article IV assessment).

7. **Weather shocks exacted a toll on output and revenue in the first quarter.** Cyclones and severe flooding damaged agricultural crops and infrastructure. The World Bank estimates the economic losses at about 1.2 percent GDP. The authorities have yet to identify sources of funding for the associated reconstruction work, which is estimated to cost about 2.8 percent of GDP (Text Table 1). Droughts in other regions have depressed agricultural output and heightened the need for social assistance. In general, the institutions assigned to deal with disaster relief are underfunded relative to the size of recurrent climatic shocks.

Text Table 1: Estimated Rehabilitation Costs from Climactic Shocks in 2015

	Percent of GDP
Agriculture and fishing	1.3
Transport	0.8
Water and sanitation	0.4
Education and health	0.3
Other (incl. housing and energy)	0.0
Total	**2.8**

Source: World Bank.

B. Fiscal policy

8. **Confronted with difficulties in budget execution in 2014 and 2015, the authorities have taken measures to strengthen fiscal policy and preserve stability**. While revenues rose in 2014 compared to 2013, they fell short of projections (reaching 9.9 percent of GDP versus a target of 11.0 percent in the supplementary budget). The combination of this revenue shortfall, delays in donor financing, arrears repayments, and unanticipated spending needs (notably from state-owned enterprises (SOEs) and the civil service pension funds) put pressure on budget execution. In response, the authorities cut other spending (especially delaying civil service recruitment and domestically financed investment), expanded the float (accounts payable), and increased statutory advances from the central bank (for 1.4 percent of GDP)—these responses transferred much of the financing pressures to 2015. Consequently, the overall deficit in 2014 was kept to 2.3 percent of GDP on a commitment basis, as anticipated in the supplementary budget.[5] The 2015 budget also targeted ambitious increases in revenue accompanied by savings in subsidies and transfers to SOEs. Fiscal reforms to support these targets gained momentum (below); however, despite some improvement over 2014, the results did not fully materialize as projected. Consequently, the authorities curtailed other planned spending to preserve budget execution consistent with

[4] These operations created a wedge between the official published exchange rate and the market exchange rate. In early September, the wedge was over 10 percent, but it disappeared following the end of the buyback operations.

[5] The 2014 deficit on a cash basis was 2.4 percent of GDP (compared to 3.5 percent envisaged in the supplementary budget).

macroeconomic stability. Relative to the budget, spending appropriations have been reduced for goods and services, including in social sectors, and domestically-financed investment (Text Table 2).

9. Efforts are underway to address structural fiscal weaknesses, although existing constraints have led to uneven progress. Tighter financing constraints, both in 2014 and 2015, have also led to mixed progress on arrears. Following agreement on a repayment plan with most tax creditors in 2014, some additional arrears on VAT refunds to exporters, as well as on government payments to JIRAMA's suppliers, continued to accumulate in late 2014 and 2015. The authorities are negotiating the settlement of outstanding arrears and bills by issuing treasury bills to creditors and are developing a framework to manage and prevent the recurrence of arrears (IMF technical assistance (TA) is underway on this issue). The authorities are also seeking to reduce reliance on central bank financing by reducing the stock of statutory advances at end-December 2015. Progress was also made on the implementation of the PFM priority action plan 2014-15, including on a census of public agencies and the preparation of outstanding Budget Report Acts covering 2008-11 for submission to parliament.

10. Despite measures, revenue collections in 2015 have only stabilized relative to the economy, contrary to initial projections. Despite rising by 22 percent year-on-year through September (gross basis), tax collections are projected to reach only 9.9 percent of GDP again in 2015, versus an initial projection of 11.5 percent in the budget. During the 2009-13 crisis, the combination of growing informality, weaker revenue administration, and increasing corruption dragged tax revenues down to very low levels. Revenue performance in 2015 has been weighed down by slower-than-projected growth in imports and the economy in general, especially the mining sector. The tax and customs administrations have begun to implement measures to deter fraud, recover tax arrears, improve controls and verifications, and reduce exemptions (MEFP ¶11).[6] Results have been limited so far, however, as the implementation of planned reforms have encountered structural obstacles, including regulatory constraints on the tax and customs administration (Figure 4) and weaknesses in judicial processes.

Text Table 2. Revisions to Central Government Spending in 2015

	Budget	Revised Proj.	Difference
	(MGA billion)		(Percent)
Wages and salaries	1,775	1,647	-7
Goods and services	261	167	-36
Of which: Social sectors	108	76	-30
Transfers and subsidies	844	1,008	19
Of which: JIRAMA	*85*	*179*	111
Air Madagascar	*0*	*28*	-
Civil Service Pension Funds	*150*	*250*	67
Interest charges	343	250	-27
Domestically-financed investment	422	179	-58
Foreign-financed investment	868	1,204	39
Central bank recapitalization	0	340	-
Arrears clearance	118	229	94
TOTAL	**4,631**	**5,025**	**9**

Sources: Malagasy authorities and IMF projections

[6] Tax suspensions on non-JIRAMA related oil imports were eliminated in early 2015. In addition, the authorities are strengthening the monitoring of tax exemptions with a view to limiting fraudulent appropriations and assessing their effect on the tax base.

11. Efforts are ongoing to generate savings on less productive spending and improve expenditure management (MEFP ¶17)**.** Transfers to JIRAMA have been cut from last year (0.6 percent of GDP in 2015 versus 1.7 percent), thanks largely to drops in fuel costs and electricity theft, even though they exceeded the initially budgeted amount. The authorities have issued a decree to improve the management of commercial SOEs, including clarifying the role of the state and changed the management and Board of Air Madagascar, where losses also exceeded expectations. Adjustments in consumer fuel prices combined with falling world prices have cut the cost of fuel subsidies from 0.4 percent of GDP in January-July 2014 to 0.1 percent for the same period this year. Finally, audits of public payroll data have started a cleansing of "ghost workers," yielding savings.

C. Monetary and financial sector policies

12. Despite strong money growth in 2015, liquidity conditions have become tight for most banks (Table 7). Fiscal deficit financing through "statutory advances" from the central bank accelerated base money growth in late 2014. Banks used the liquidity to increase both their lending to the private sector and their holdings of T-bills in the first half of 2015. However, in the second half of 2015, liquidity has become constraining for most banks; while aggregate liquidity appears adequate, the system is highly segmented, with just three banks (out of eleven) holding nearly 80 percent of liquidity. The liquid banks appear to have binding internal risk management limits that constrain their participation in the T-bill market,[7] leading to limited demand and higher interest rates (reaching 12 percent on one-year T-bills).[8] In response, the central bank in October reduced both the reserve requirement from 15 percent to 13 percent and the reference interst rate from 9.5 percent to 8.7 percent (the first adjustment since 2004, see Figure 5).

13. The authorities have initiated several actions to strengthen the central bank's capacity in 2015. The actions aim to make monetary policy more active and enhance the bank's capacity to safeguard macroeconomic stability:

- Revisions to the Central Bank Act are being developed to (i) gradually reduce central bank statutory advances to the government; (ii) automatically transfer central bank losses and profits to the government; and (iii) establish an Audit Committee of the Board of Directors.
- Deposit auctions and sales of treasury bills were reintroduced to improve liquidity management.
- The central bank was recapitalized in June 2015 by the government settling overdue interest payments equal to 0.4 percent of GDP.
- In connection with ending buyback operations, the central bank increased transparency in the foreign exchange market in September by starting to report daily minimum and maximum exchange rates for transactions, in addition to the average exchange rate.

[7] In addition, the inter-bank market remains nascent. In a context of persistent uncertainty, high counter-party risk, and weak legal recourse, liquid banks are reluctant to lend to other banks or new corporate clients.

[8] Bank holdings of T-bills fell from 3.2 percent of GDP at end-May 2015 to 2.5 percent at end-September 2015, reflecting both structural and seasonal factors.

- New investment guidelines and a new directive on reserve management were approved.
- A joint IMF/World Bank Financial Sector Assessment Program (FSAP) is underway.

D. Inclusive growth and investment

14. The strategy for inclusive growth and poverty reduction has been refined, although implementation requires more resource mobilization. The implementation plan for the National Development Plan (NDP) and the Presidential Plan of Urgent Action (PPUA) was finalized in June 2015, and it will be the foundation for a donor conference planned for 2016. Full NDP implementation will require substantial public investment financed partly externally and partly through domestic revenue mobilization. The steering committee on investment priorities, established in March 2015, is working to strengthen project implementation and a prioritized investment plan will be completed shortly.

OUTLOOK AND POLICY DISCUSSIONS

15. In light of the slow recovery and budget tensions, the authorities have recently intensified their reform agenda, as reflected in the SMP. While Madagascar will ultimately need broad-based reforms to support sustained growth over the medium-term, short-term measures should be focused and realistic in light of existing capacity constraints. The policies under the agreed SMP focus on: (i) creating fiscal space for priority spending; (ii) reinforcing macroeconomic stability by strengthening the central bank and monetary policies; and (iii) starting to unlock the potential for sustained inclusive growth.

16. Economic growth is projected to accelerate somewhat in 2016 to 4.3 percent. Growth would be driven by a rebound in agricultural production, a modest recovery in textile exports (including to the US following the restoration of AGOA trade privileges in 2015), and a slight increase in infrastructure investment, partly financed by donors and public private partnerships. As usual, the projected growth will be exposed to the risks from slippages in implementation of reforms, particularly in fiscal policy and SOEs, as well as from natural disasters, which may be heightened by the El Niño weather pattern.

A. Creating more fiscal space

17. The overall fiscal policy goal is to create the additional fiscal space needed for a successful implementation of the NDP. The top priority is to reverse the recent trend of falling revenues relative to GDP through further changes in tax policy and administration. At the same time, it is also important to make the best use of limited fiscal resources by reprioritizing spending, strengthening public financial management (PFM), and improving the selection of investment projects.

18. New revenue measures aim to stabilize tax revenues in 2015 and lead to a modest increase in 2016 (MEFP ¶11, ¶18). Drawing on TA recommendations, administrative measures to be launched in 2015 focus on further strengthening customs control procedures (including setting up remote audit teams to conduct ex-post verification of suspicious operations (benchmark, MEFP Table 2)), recovering tax arrears, and limiting the abuse of exemption rules. The draft revisions to the 2015 budget[9] and the draft 2016 budget introduce several tax policy initiatives (prior action, MEFP Table 2), including: increased excise duties on beverages; a new tourist arrival fee of US$25 per visitor; and limiting sales by Economic Processing Zones companies to the domestic market and subjecting them to customs duties and taxes (benchmark, MEFP Table 2). Relying on these measures, the budget targets an increase in the collection of tax revenues of ½ percent of GDP in 2016.[10] The customs and tax administrations are also drawing up medium-term plans for continued modernization. In addition, a review of the institutional framework for mining and petroleum activities and their taxation will be completed by end-2015, with a view to ensuring an appropriate revenue contribution in the long run (MEFP ¶15-16).

19. The government will also intensify efforts to improve the composition and quality of fiscal spending (MEFP ¶17, ¶19-22). The fuel price subsidy—whose benefits tend not to accrue to the most vulnerable—will be eliminated through the adoption of an automatic pricing formula to maintain full cost-recovery fuel prices from end-December 2015 (continuous benchmark, MEFP Table 2). Specific reform strategies are being developed for JIRAMA and Air Madagascar with World Bank assistance. Budget transfers to pension funds will be addressed through a clean-up of the pension rolls and parametric pension reforms. More cost savings are also expected from the continuing audit of civil service pay data. To bring the accumulation of arrears under better control, the authorities will establish a framework to define, identify, and monitor arrears on expenditure of the central government and key SOEs by end-December 2015. In addition, an escrow account will be created at the Central Bank to ring fence the resources required by VAT reimbursements starting January 1, 2016 (benchmark, MEFP Table 2). Implementation of a PFM reform agenda covering 2014-15 is also continuing.

20. The projected fiscal deficits in 2015 and 2016 are consistent with medium-term sustainability, although the limited availability of financing creates difficulties. The overall fiscal deficit (commitment basis) is projected at 3.3 percent of GDP in 2015, excluding the central bank recapitalization.[11] The demand for domestic government securities, as well as the availability of external concessional financing, is limited, however. As a result, residual financing needs are expected to be met by an external bank loan on commercial terms to be signed shortly. The projected deficit (commitment basis) in 2016 is 3.2 percent of GDP. To finance the 2016 budget, the

[9] The draft revisions to the 2015 budget were submitted to parliament together with the draft 2016 budget at the end of October and are expected to become effective toward the end of the year.

[10] The total increase is 0.8 percent of GDP, including a one-off payment by Air Madagascar of tax arrears that is financed by an offsetting fiscal transfer.

[11] The 2015 deficit (commitment basis) is projected to be 4.5 percent of GDP including the recognition of old government debt owed to the central bank. Considering ongoing arrears clearance, the corresponding deficit on a cash basis that needs to be financed rises to 5.3 percent of GDP.

authorities need external financing that is not yet identified equivalent to 2 percent of GDP (roughly US$200 million).[12] The authorities are in discussions with development partners on the availability of external budget financing.

B. Strengthening central bank capacity to support stability

21. Changes in the operations of the central bank aim to enhance its capacity to support macroeconomic stability (MEFP ¶30). Central bank financing of the fiscal deficit, petroleum subsidies, and associated large and volatile swings in excess bank reserves have created challenges to the macroeconomic stability in recent years. To strengthen central bank independence, governance, and accountability, the authorities are planning to submit a revised Central Bank Act for Cabinet approval by end-December 2015 (benchmark, MEFP Table 2) that tightens limits on financing to the government and reinforces governance and management. The government will also compensate the central bank for losses made during 2011-13 by issuing securities worth 0.8 percent of GDP, further restoring the financial position of the central bank.[13] To improve transparency, the central bank will adhere to International Financial Reporting Standards (IFRS) starting in 2016.

22. The central bank is committed to maintaining a flexible exchange rate and improving the functioning of the interbank foreign exchange market (MEFP ¶29). The authorities will refrain from reintroducing buyback operations (continuous benchmark, MEFP Table 2) and plan to limit interventions to a gradual accumulation of foreign exchange reserves, in the absence of extraordinary volatility in the exchange rate. The exchange rate will adjust to economic fundamentals. The temporary 100 percent surrender requirement introduced in August will expire at end-December 2015, and the authorities are committed to minimizing any resort to administrative measures to restrict foreign exchange outflows and fully respecting their commitments under Article VIII.

23. The central bank is committed to a more active monetary policy (MEFP ¶27-28). The current growth of broad money and private sector credit is positive to the extent it reflects financial deepening, but vigilance is warranted to avoid any inflationary effects or risks of fiscal dominance. Going forward, the central bank will progressively focus on keeping inflation in single digits and building adequate reserves; in particular, with technical support from the IMF, it will work toward setting explicit bank liquidity targets and meeting them by actively using Treasury bill sales, deposit auctions, and credit auctions. The central bank's reference (policy) interest rate will be adjusted more frequently to signal movements in the money market. Enhancing the efficiency of the interbank

[12] The 2016 financing gap does not yet take into account any programmatic budget support loans (i.e., not for foreign financed investment projects). In 2015, Madagascar received about 1 percent of GDP in programmatic budget loans.

[13] The central bank's financial position will improve significantly in 2015 as a result of two recapitalization operations (together 1.2 percent of GDP). (For the government, the recapitalization is self-financed through issuance of new debt instruments.) The central bank's capital needs will be reviewed following the adoption of IFRS starting in 2016.

market is also important, since its segmentation is complicating the implementation of monetary policy and government financing.

24. Indicators of financial soundness do not suggest any serious immediate concerns, and the FSAP currently underway will provide a more in-depth assessment. The banking system has weathered economic storms despite deficiencies in prudential regulation and supervision, and in the bank intervention framework. The capital adequacy ratio is comfortable, notwithstanding a slow decline in the context of a brisk recovery in private sector credit. The banking sector enjoys high profitability, and deposits exceed loans for the system as a whole, allowing some banks to place excess liquidity with their parent banks abroad. Microfinance institutions (MFIs) are growing rapidly; while many are financially fragile, their aggregate balance sheet remains very small relative to that of the commercial banks.

C. Starting to unlock the potential for sustained inclusive growth

25. The key medium-term challenge remains to secure strong, sustainable, pro-poor growth, which will help reverse the deterioration in development indicators. Poverty-reducing growth will require enhancing the productivity of all segments of the population, including marginalized groups, particularly in rural areas. This ultimately requires a set of policies that advance: (i) investment in key infrastructure, especially power, transportation and resilience to natural disasters; (ii) stronger economic governance, including fighting corruption and encouraging entrepreneurship; and (iii) an enhanced human capital base through investment in education, health and social protection.

26. Near-term policies under the SMP focus on strengthening the foundation for investment and social protection policies (MEFP ¶23-26, ¶34). The authorities' investment plans emphasize infrastructure and social spending, relying largely on external borrowing on concessional or near concessional terms (Table 8). To maximize the benefits and manage the risks from external borrowing, the authorities will: (i) bring the DMFAS database into full operation and publish details on the stock and flows of public and publicly-guaranteed debt by end-March 2016 (benchmark, MEFP Table 2);[14] (ii) implement a careful process of investment prioritization to scale up investment in critical infrastructure, including by limited non-concessional borrowing (consistent with Madagascar 'weak' debt monitoring capacity and 'moderate' risk of external debt distress (DSA, Appendix 2), the SMP includes a non-concessional borrowing ceiling of US$200 million, commitment basis); and (iii) submit a law on public-private partnerships (PPPs) to the parliament by end-December 2015. To enhance the design and implementation of social protection programs, the Cabinet will approve the National Social Protection Policy by end-December 2015 (benchmark, MEFP Table 2). Improved regulation and supervision of MFIs is also a priority to protect consumers and sustain stability, an issue the FSAP will examine further. In addition, plans to improve the

[14] This will support an improvement in the capacity of Madagascar to monitor its debt.

business climate and the performance of key SOEs like JIRAMA and Air Madagascar, including service delivery, are central to successful inclusive growth.

27. The government has adopted a new strategy to fight corruption and improve governance (MEFP ¶17, ¶33). Enduring governance challenges deepened further during the 2009-13 crisis. Corruption, illegal logging, and other illicit activities increased. The National Anti-Corruption Strategy adopted in September 2015 involves a broad set of actions, including: strengthening the judiciary and sanctions system to punish corrupt behavior; increasing communication about corruption; coordinating international support against corruption; setting aside sufficient fiscal resources; and mobilizing the general population. The authorities will also initiate an evaluation of the effectiveness of the current sanction system, including the *Conseil de Discipline de la Fonction Publique*, by end-March 2016, and increase the budget for agencies dedicated to fight corruption by 50 percent in the 2016 budget.

PROGRAM RISKS AND CAPACITY BUILDING

28. The economic program and projections are subject to significant uncertainty and risks (Box 1. Risk Assessment Matrix)**.** Major risks stem from: (i) political uncertainty and disappointing progress in fighting corruption that could reduce reform implementation, economic confidence, donor support, and tourism earnings; (ii) the need for additional transfers to cover losses in JIRAMA and Air Madagascar; and (iii) failure to secure all of the projected external financing in 2015. If any of these events were to materialize, priority spending on investment and social development could be crowded out, and additional domestic arrears might accumulate.

29. Capacity building has been an integral part of the re-engagement with Madagascar since 2014. Many of the ongoing or planned reforms draw heavily on TA missions from the IMF, World Bank, African Development Bank, and others. The TA provided so far has focused on near-term, quick impact measures to improve revenue generation, public financial management, and central bank operations. While fiscal issues will continue to play a major role, the ongoing FSAP will set the stage for increased TA on financial sector issues over the next year.

PROGRAM DESIGN AND CAPACITY TO REPAY

30. The SMP covers a six-month period, September 2015 through March 2016, and will be monitored based on quantitative targets and structural benchmarks (MEFP, Tables 1 and 2). The targets include ceilings on the accumulation of new external payment arrears, external borrowing on non-concessional terms, the central bank's net domestic assets, and net bank credit to the government, and floors on the central bank's net foreign assets, social priority spending, and gross tax revenue.

31. The debt sustainability analysis (DSA) indicates that Madagascar has moved from 'low' to 'moderate' risk of debt distress (DSA, Appendix 2). Debt indicators have deteriorated since the last DSA (June 2014), mainly as a result of greater than anticipated exchange rate depreciation.

Weak revenue generation remains the greatest source of risk to debt sustainability. Madagascar's capacity to repay the Fund remains adequate (Table 10).

32. The last safeguards assessment was completed in January 2015. The CBM has taken or is planning to take steps to address the assessment's priority recommendations, including on its legal framework, transparency, and audit quality.

STAFF APPRAISAL

33. Madagascar's economic recovery has proven slower than expected, due in large part to external shocks and deep-rooted structural problems. Falling world prices for commodity exports and weather-related shocks have contributed to slower growth. At the same time, political uncertainty, poor governance (including corruption), and weak institutions (including SOEs and the judiciary) have restrained private investment, slowed the implementation of reforms, and delayed their benefits. In this context, financing and balance of payments needs have grown.

34. In spite of this challenging economic environment, the government has broadly maintained macroeconomic stability while launching measures to strengthen it. Notwithstanding exogenous shocks and slower economic growth, the authorities have preserved single-digit inflation and the import coverage of international reserves. Fiscal and current account deficits also remain compatible with medium-term sustainability. The real exchange rate has depreciated modestly, reflecting nominal flexibility, and is broadly aligned with economic fundamentals. To maintain macroeconomic stability, the government has had to curtail spending plans owing to weak revenue collections, larger-than-budgeted transfers to state-owned enterprises, and binding limits on central bank financing. Progress on arrears clearance has also been mixed at best, because of the tight budget constraints.

35. Despite maintaining stability under difficult circumstances, the authorities recognize the need to improve results to achieve development over the medium-term. Economic growth is currently only keeping pace with the rising population, and public investment in physical, human, and institutional capital has not yet reached a level sufficient to support sustainable growth. Resilience to natural disasters remains a concern. The authorities have appropriately intensified their efforts, stressing an increase in domestic revenue collections as an immediate priority. Effectively sanctioning tax evasion is a key to improved results. At the same time, it is important to improve the quality of spending by reducing the need for transfers to loss-making SOEs as well as eliminating the inefficient fuel subsidy. In addition, the authorities need to avoid the build-up of new arrears and settle the existing stock expeditiously, as they undermine confidence in public finances and hold back private sector-led growth. These enhancements to the quality of fiscal policy will enable the authorities to increase priority spending, without unsustainable increases in the fiscal deficit or domestic financing. Strengthening governance, cutting corruption, and improving the business climate are also essential to success; staff welcomes the authorities' commitment to building their capacity with the ultimate objective of implementing a successful medium-term program.

36. The impact of the authorities' investment plans depends both on enhancing the investment process and on mobilizing additional financing. Ongoing efforts to carefully prioritize projects based on economic impact are central. To reconcile the substantial needs with debt sustainability, the authorities need to rely as much as possible on external concessional financing, for which the needs are considerable. If any non-concessional borrowing is required, it should be limited in size and longer in maturity. A sound legal foundation for public-private partnerships (PPPs) is also important to establish the right incentives for all parties and to limit public liabilities.

37. Staff welcome the authorities' actions to enhance the functioning of the foreign exchange market, maintain a flexible exchange rate, and strengthen the central bank's capacity. Discontinuing buy-back operations, bolstering transparency, and implementing exchange rate flexibility significantly enhance external sustainability. The gradual accumulation of foreign exchange reserves, combined with an RCF disbursement, boost an important policy buffer. Staff urged the authorities to minimize recourse to administrative measures restricting foreign exchange outflows and to ensure full compliance with Article VIII obligations. The ongoing recapitalization of the central bank, revision of its legal framework, and more active liquidity management will reinforce its capacity to safeguard price and financial sector stability. The recent easing of monetary policy was an understandable reaction to tight bank liquidity and does not appear to pose immediate risks to macroeconomic stability. For the medium-term, however, these challenges highlight the need both to enhance the quality of fiscal policy and to address structural weaknesses in the financial sector. While financial deepening is an important objective, it is vital that it remains compatible with price and financial sector stability.

38. Staff supports the authorities' request for a disbursement under the RCF in the amount of SDR 30.55 million (25 percent of quota), based on the policy track record over the past six months. The authorities have maintained economic stability and sustainability under demanding conditions with an adequate policy mix. The RCF disbursement, in combination with the SMP, would supplement the authorities' own policy efforts, help build reserves, and catalyze additional donor financing. In addition to helping guide policy, the SMP provides an opportunity to begin demonstrating a track record necessary to implement a successful medium-term economic program, which in turn would support a request for an arrangement under the Extended Credit Facility. The challenges for qualifying for an ECF arrangement would include exhibiting the capacity to sustain reforms in key areas, especially revenue collections, economic governance and management of SOEs. This capacity would in turn help mobilize the domestic and external resources to ensure adequate financing. Future Fund engagement will also be guided by recommendations from the ongoing FSAP.

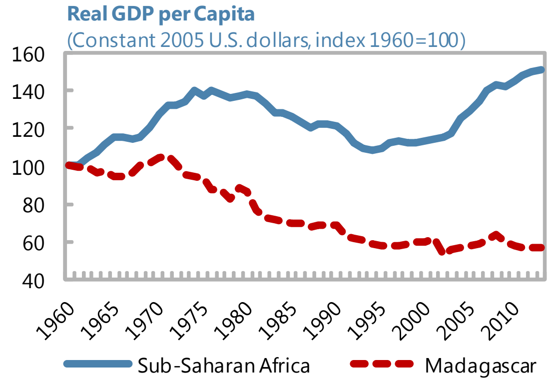
Box 1. Madagascar: Risk Assessment Matrix [1/]

Source of Risks	Relative Likelihood	Potential Impact	Policy Response
Domestic Risks			
Political uncertainty and disappointing progress in fighting corruption.	High	High: Reduced inflow of FDI and donor support. Reduced export earnings from tourism. Reduced implementation of reform and reduced fiscal space impeding delivery of public services.	Maintain exchange rate flexibility and reallocate fiscal spending to support of the most vulnerable. Encourage authorities and development partners to protect spending in priority social areas.
Larger than anticipated transfers to SOEs (JIRAMA and Air Madagascar).	High	High: Reduced fiscal space would impede the government's ability to deliver public services.	Protect key public services in budget. Encourage authorities and development partners to protect spending in priority social areas. Minimize accumulation of new arrears. Consider private management of specific units or operations.
External Risks			
Structurally weak growth in the Euro Area.	High	High: Uncertain/slow donor support reduces fiscal space, impeding the ability to deliver public services. Slower growth in tourism.	Energize donor support through a concerted campaign emphasizing the merits and needs of the medium-term development plan; look within budget for ways to protect key public services. Maintain exchange rate flexibility. Diversify tourism markets.
Cyclones, floods, and droughts.	Medium	Medium: Loss and damage of physical and human capital and lower growth.	Reallocate fiscal spending to finance recovery work and make appeal to donors for post-disaster financing. Build buffers and resilience.
Sharp China slowdown in 2015-16	Low	Medium: Depressed prices of commodities, mainly nickel, reduces export earnings and tax revenue.	Maintain exchange rate flexibility and continue with revenue reforms to expand the local tax base.

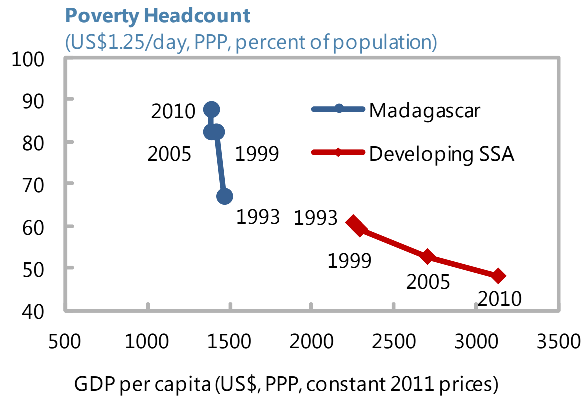
[1/] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of the IMF staff. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to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

Figure 1. Key Developments, 1960-2015

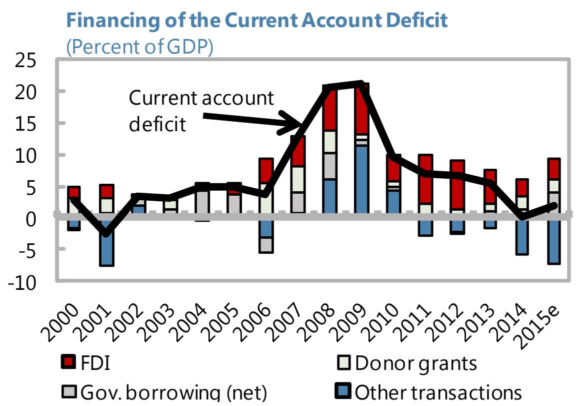
Madagascar's real per capita GDP has been trending downward and ...



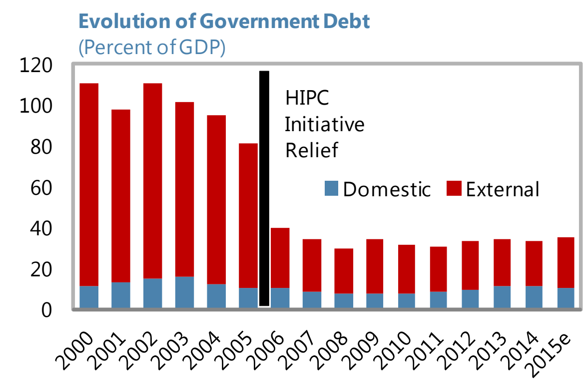
... as a result, poverty has increased and become more widespread.



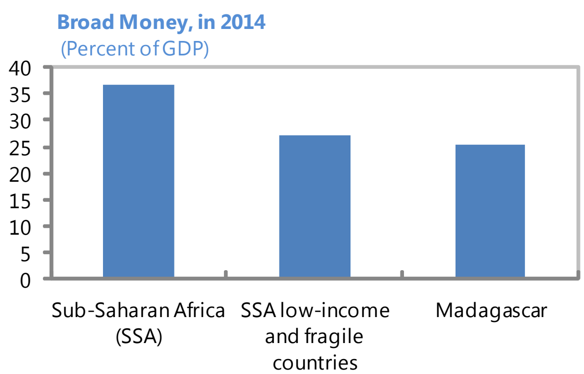
Large mining projects have been the main reason behind large current account deficits.



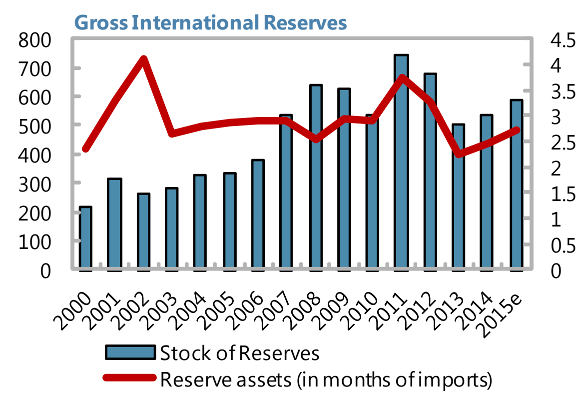
External debt has remained low and stable after HIPC debt relief.



Financial deepening is lagging behind most countries in Sub-Saharan Africa.



International reserves are recovering after the 2009-13 political crisis.

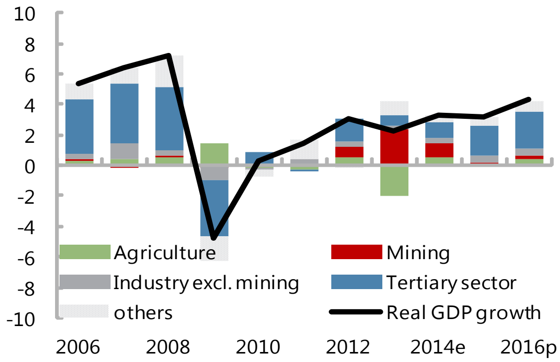


Sources: Malagasy authorities; the World Bank, *World Development Indicators*; and IMF staff estimates and projections.

Figure 2. Real Sector Developments, 2006-16

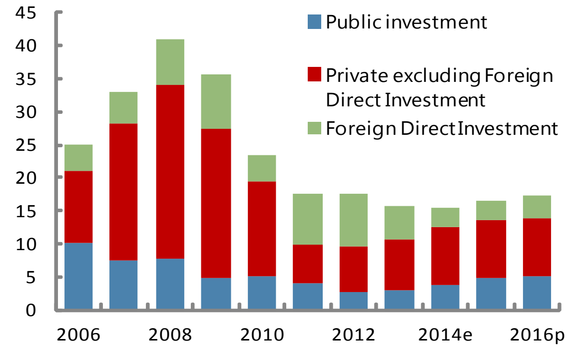
Mining (first construction and then production) was the main engine of growth during the 2009-13 crisis.

Real GDP growth and Sector Contribution to Growth
(Percent)



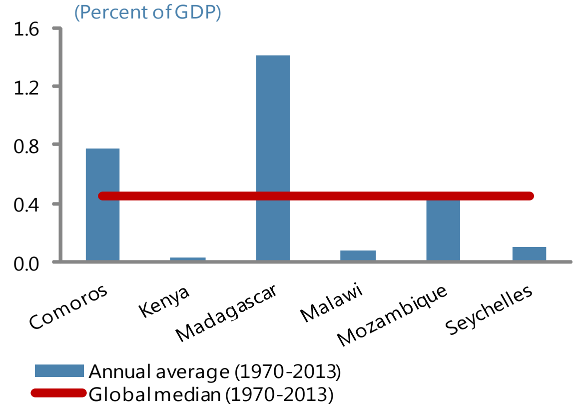
Private and foreign direct investment have fallen significantly due to weak confidence.

Investment (Public - Private)
(Percent of GDP)



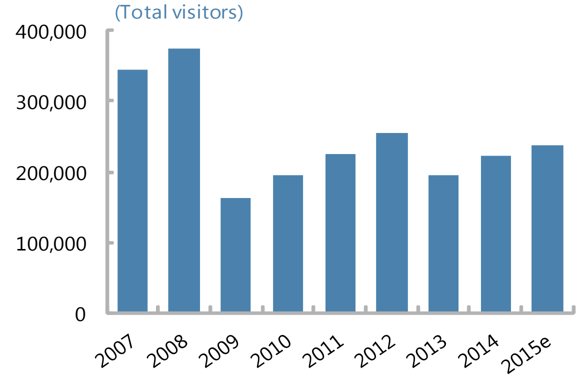
Madagascar is prone to costly natural disasters.

Damage by Natural Disasters
(Percent of GDP)



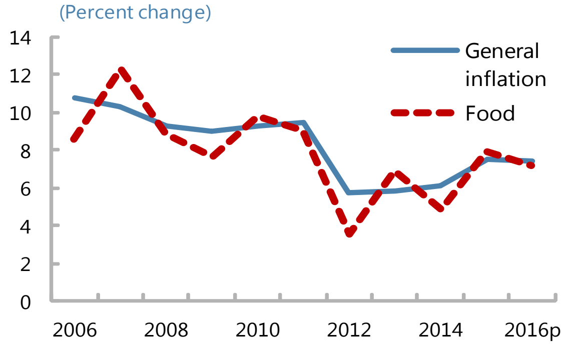
The post-crisis recovery in tourism has stalled, partially due to problems at Air Madagascar.

Tourism
(Total visitors)



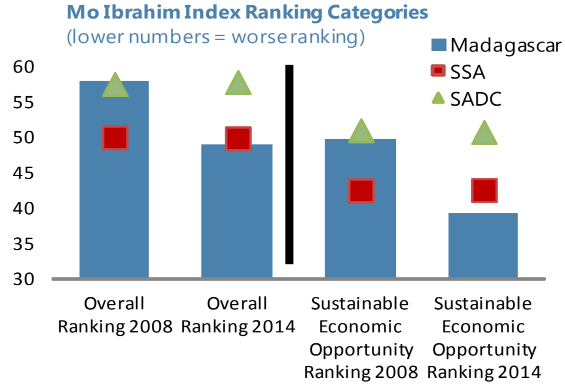
Inflation has remained contained despite macroeconomic challenges in recent years

CPI average
(Percent change)



Between 2008-14, Madagascar's ranking deteriorated more than any other non-conflict country in the Mo Ibrahim Index.

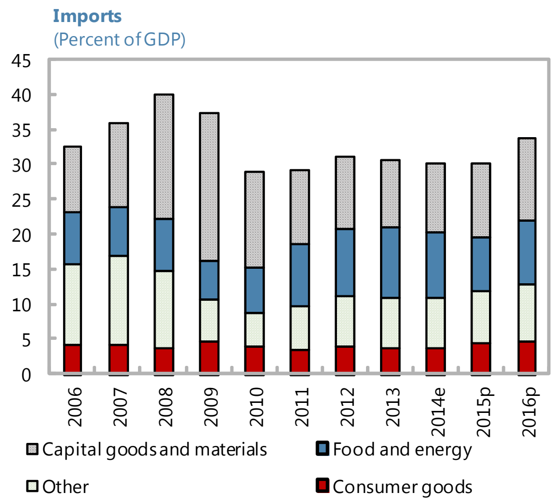
Mo Ibrahim Index Ranking Categories
(lower numbers = worse ranking)



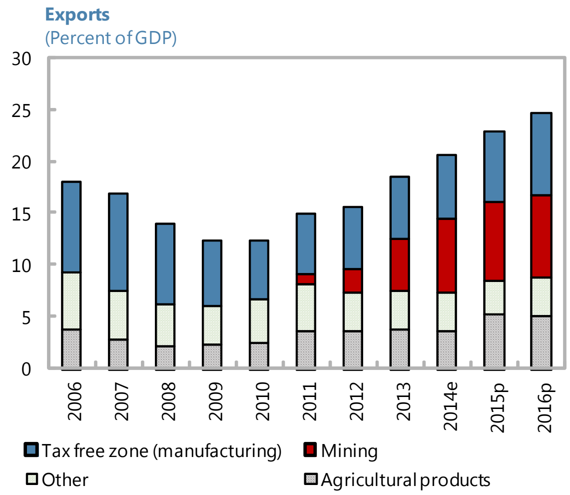
Sources: Malagasy authorities; EM-DAT/CRED.; Mo Ibrahim Index, 2015; and IMF staff estimates and projections.

Figure 3. External Sector Developments, 2006-16

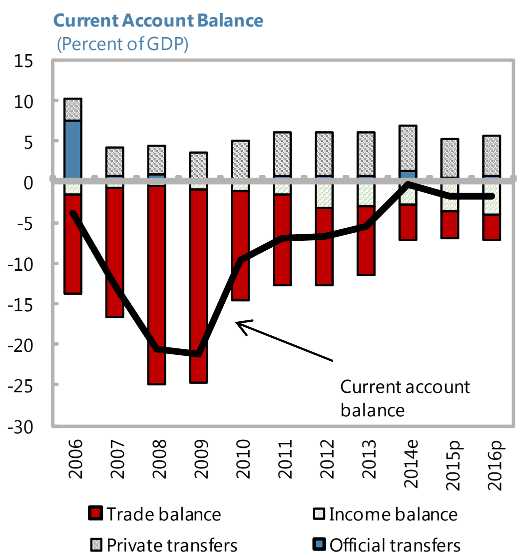
Imports are dominated by food, energy, and capital goods and materials used in the large mining projects...



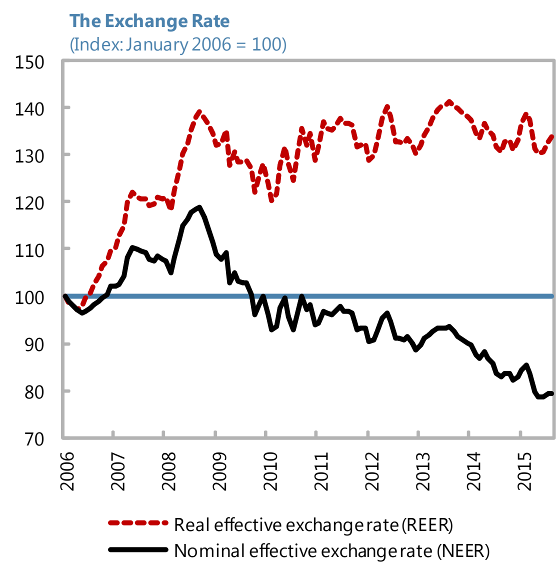
... and these projects have now started to generate export earnings.



The large mining projects explain most of the movements in the trade and current account balances.



While the NEER is depreciating, higher inflation than in its trading partners has kept the REER relatively stable.

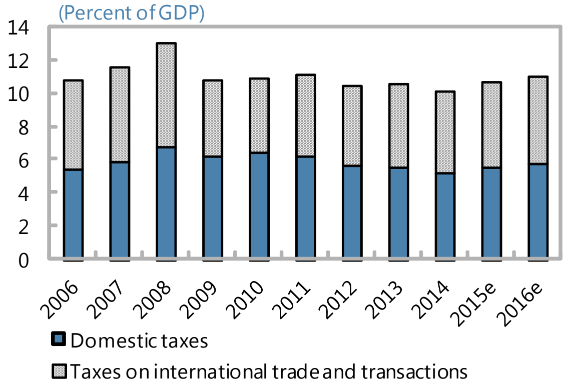


Sources: Malagasy authorities; and IMF staff estimates and projections.

Figure 4. Fiscal Developments, 2006-16

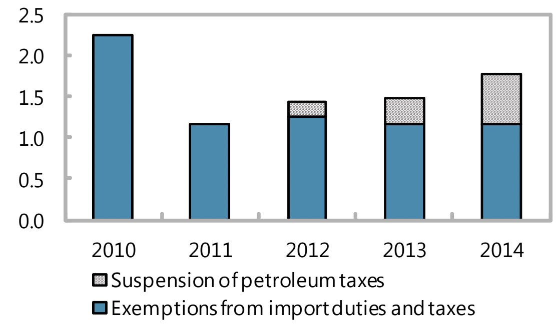
The mobilization of fiscal revenue remains challenging…

Gross Tax collections
(Percent of GDP)



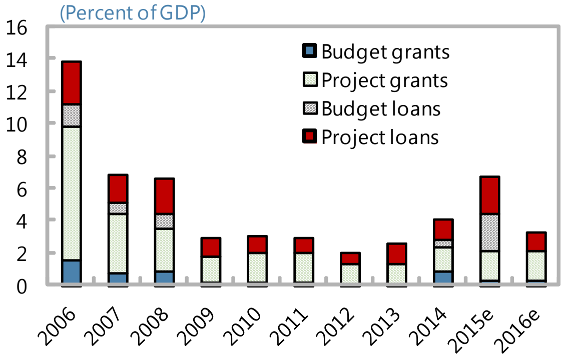
…partly as a result of tax exemptions and suspensions.

Estimated Costs of Exemptions and Suspension of Petroleum Taxes
(Percent of GDP)



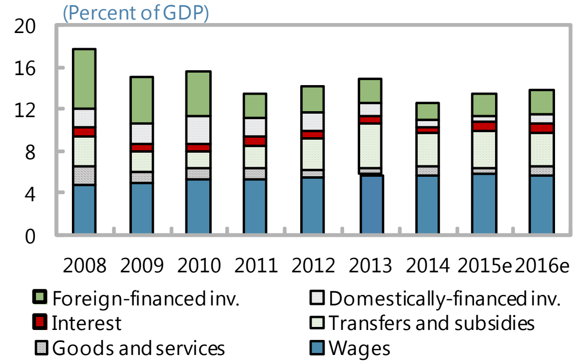
Donor flows also remain well below their pre-political crisis levels.

Donor Flows
(Percent of GDP)



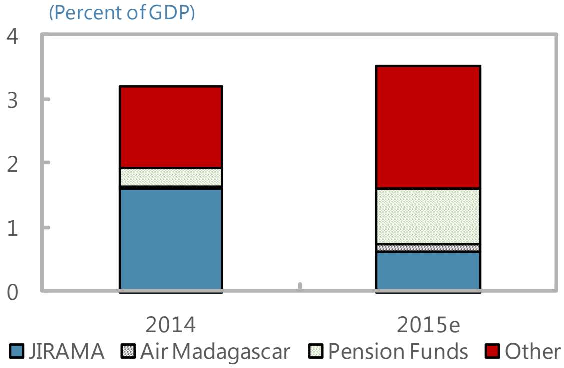
Subsidies and transfers continue to absorb a large but slowly shrinking share of spending…

Budgetary Spending
(Percent of GDP)



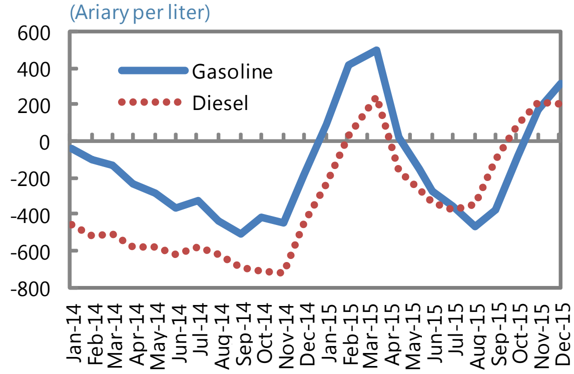
…mainly driven by transfers to SOEs and occupational pensions

Share of total budgetary transfers and subsidies
(Percent of GDP)



The gap between pump and reference prices is projected to turn positive in October 2015, eliminating the need for subsidies.

Gap between Administered Pump Price and Reference Price
(Ariary per liter)

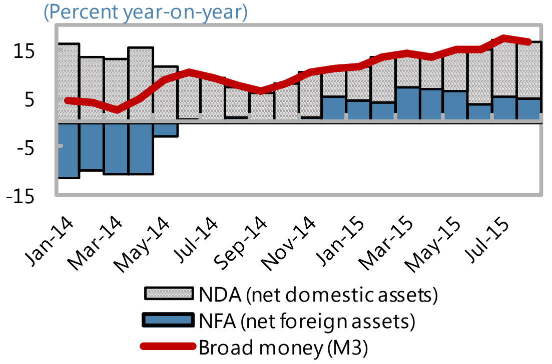


Sources: Malagasy authorities; and IMF staff estimates and projections.

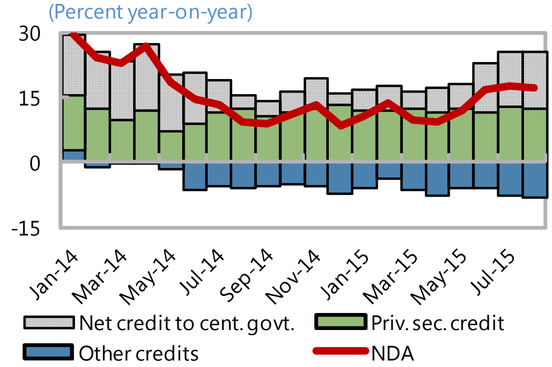
Figure 5. Monetary Developments, 2014-15

Broad money growth is strong driven primarily by private sector credit growth (about 16 percent year-on-year in August 2015) and central bank financing of the government.

Money Growth and Contribution from NFA and NDA
(Percent year-on-year)

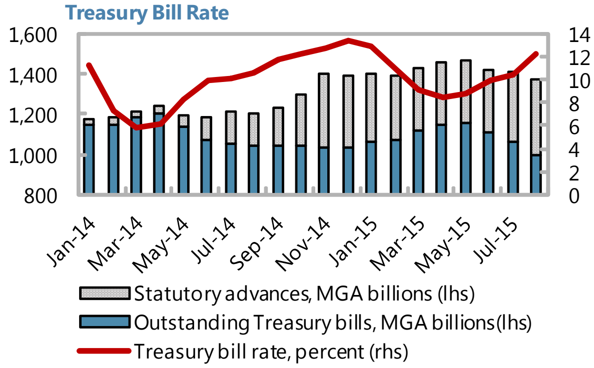


NDA Growth and Contributions from Different Credits
(Percent year-on-year)



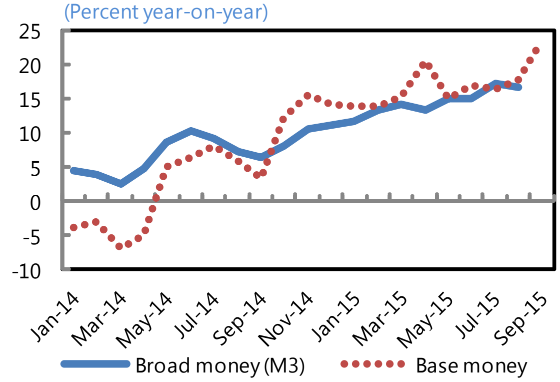
Risk limits constrained the banks' demand for treasury bills, which statutory advances partially offset ...

Outstanding Stock of Treasury Bills and One-Year Treasury Bill Rate



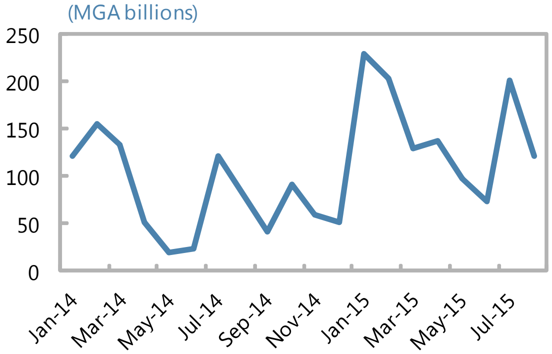
... contributing to stronger growth in base money.

Broad Money and Base Money
(Percent year-on-year)



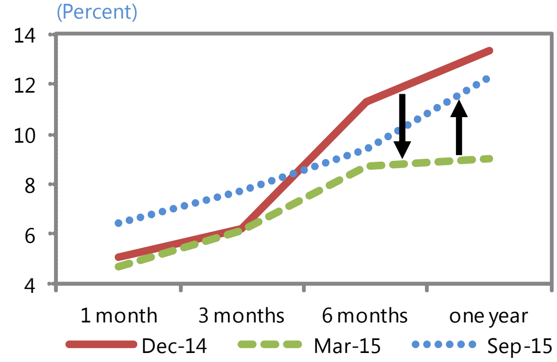
In aggregate, the banking system had excess reserves in early 2015, although liquidity later became tight for most banks.

Excess Bank Reserves
(MGA billions)



The yield curve has steepened again in recent months.

Treasury Bill Interest Rates
(Percent)



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

Table 1. Madagascar: Selected Economic and Financial Indicators, 2013–16

	2013	2014	2015	2016
	Actuals	Prel. Est.	Projections	
	(Percent change; unless otherwise indicated)			
National account and prices				
GDP at constant prices	2.3	3.3	3.2	4.3
GDP deflator	5.1	6.6	7.6	7.4
Consumer prices (end of period)	6.3	6.0	7.9	7.2
External sector				
Export of goods volume	21.7	5.7	13.9	5.9
Import of goods volume	11.1	4.6	-0.8	6.5
Terms of trade (deterioration -)	10.3	12.6	-4.0	-2.8
Money and credit				
Reserve money	-6.1	14.1	10.8	11.9
Broad money (M2)	9.0	9.8	10.9	14.9
	(Growth in percent of beginning of period money stock (M2))			
Net foreign assets	-15.8	6.1	11.5	6.6
Net domestic assets	24.9	3.7	-0.6	8.3
of which: Credit to the private sector	8.1	9.7	7.5	8.0
	(Percent of GDP)			
Public finance				
Total revenue (excluding grants)	9.6	10.1	10.3	10.9
of which: Tax revenue [1]	9.3	9.9	9.9	10.7
Grants	1.3	2.3	2.1	2.1
Total expenditures	14.9	14.7	16.9	16.2
Current expenditure	11.8	10.8	12.1	11.0
Wages and salaries	5.7	5.6	5.8	5.6
Interest payments	0.7	0.6	0.9	0.9
Other	4.8	4.1	4.1	4.0
Goods and Services	0.6	0.9	0.6	0.8
Transfers and Subsidies	4.1	3.2	3.5	3.1
Treasury operations (net)	0.6	0.6	1.3	0.5
Capital expenditure	3.1	3.9	4.8	5.2
Domestic financed	0.6	1.2	0.6	1.5
Foreign financed	2.5	2.8	4.2	3.7
Overall balance (commitment basis)	-4.0	-2.3	-4.5	-3.2
Float (variation of accounts payable, - = increase)	0.2	-0.6	0.0	0.0
Variation of domestic arrears (- = increase)	-2.2	0.7	0.8	0.6
Overall balance (cash basis)	-2.0	-2.4	-5.3	-3.8
Total Financing	2.0	2.4	5.3	1.0
Foreign borrowing (net)	1.0	1.2	4.0	0.4
Domestic financing	1.0	1.2	1.3	0.7
Excess financing after prospective financing (- = gap)	0.0	0.0	0.0	-2.1
Savings and investment				
Investment	15.9	15.6	16.6	17.2
Government	2.5	3.9	4.8	5.2
Nongovernment	13.4	11.6	11.8	12.0
Gross domestic savings	7.5	11.3	13.3	14.0
Public	-2.0	-0.2	-1.5	0.2
Private	9.4	11.4	14.8	13.8
Gross national savings	10.3	15.3	14.8	15.4
Public	-0.9	1.6	0.4	2.0
Private	11.1	13.7	14.5	13.5
External sector				
Exports of goods, f.o.b.	18.4	20.6	22.7	24.5
Imports of goods, c.i.f.	31.7	31.2	31.3	34.8
Current account balance (exc. grants)	-6.9	-2.2	-3.9	-3.9
Current account balance (inc. grants)	-5.6	-0.2	-1.8	-1.8
Public debt	34.0	35.2	40.6	40.1
External	22.8	23.7	30.7	31.5
Domestic	11.1	11.4	10.0	8.7
	(Units as indicated)			
Gross official reserves (millions of SDRs)	502	535	590	629
Months of imports of goods and services	2.2	2.5	2.7	2.8
Real effective exchange rate				
(period average, percent change)	3.6	-3.3	…	…
GDP per capita (U.S. dollars)	462	453	400	370
Nominal GDP at market prices (billions of ariary)	23,397	25,775	28,618	32,055

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

[1] See tables 3 and 4 for details.

Table 2. Madagascar: National Accounts, 2013-16

	2013	2014	2015	2016
	Actuals	Prel. Est.	Projections	
		(Percent change)		
Real supply side growth				
Primary sector	-6.1	3.3	0.7	2.5
Agriculture	-12.8	4.5	0.6	3.3
Cattle and fishing	1.4	2.8	0.8	1.9
Forestry	-1.9	-1.0	1.0	1.0
Secondary sector	22.2	8.5	4.1	4.8
Food and drink	3.1	3.4	4.1	3.7
Export processing zone	5.9	2.1	7.1	8.0
Energy	5.6	4.2	3.1	5.5
Extractive industry	219.2	25.9	3.3	5.0
Other	-2.0	2.1	4.5	4.4
Tertiary sector	0.8	2.1	4.0	5.1
Transportation	3.6	2.2	3.3	5.6
Services	2.2	1.2	5.0	5.8
Trade	-3.4	2.9	3.1	2.8
Public administration	1.0	1.4	1.0	1.0
Public works/construction	-2.2	3.1	8.3	9.9
Indirect taxes	8.5	2.1	4.5	4.8
Real GDP at market prices	2.3	3.3	3.2	4.3
Nominal demand side composition		(Percent of GDP)		
Resource balance	-8.4	-4.3	-3.3	-3.3
Imports of goods and nonfactor services	38.7	37.1	37.7	40.7
Exports of goods and nonfactor services	30.3	32.8	34.4	37.4
Current account balance (including grants) = (S-I)	-5.6	-0.2	-1.8	-1.8
Consumption	92.5	88.7	86.7	86.0
Government	11.1	10.2	11.2	10.1
Nongovernment	81.5	78.5	75.5	75.9
Investment (I)	15.9	15.6	16.6	17.2
Government	2.5	3.9	4.8	5.2
Nongovernment	13.4	11.6	11.8	12.0
Of which: foreign direct investment	5.2	2.9	3.1	3.3
National savings (S)	10.3	15.3	14.8	15.4
Government	-0.9	1.6	0.4	2.0
Nongovernment	11.1	13.7	14.5	13.5
Memoranda items:				
Nominal GDP (at market prices)	23,397	25,775	28,618	32,055
Net factor income	-3.2	-2.8	-3.6	-4.0
Transfers	6.0	6.9	5.1	5.5
Nominal GNP	23,400	25,779	28,620	32,056

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

Table 3. Madagascar: Fiscal Operations of the Central Government, 2013-16

(Billions of Ariary)

	2013	2014	2015	2015				2016[1]	
	Dec	Dec	Dec	Mar	June	Sept	Dec	Mar	Dec
	Actuals	Prel. Est.	Budget	Prel. Est.		Projections		Projections	
Total revenue and grants	2,550	3,204	3,898	768	1,666	2,665	3,552	795	4,166
Total revenue	2,254	2,611	3,394	649	1,495	2,234	2,961	734	3,497
Tax revenue [1]	2,182	2,547	3,332	642	1,447	2,164	2,844	731	3,429
Taxes on income, profits, and capital gains	455	694	706	167	367	528	672	174	801
Taxes on international trade and transactions	1,172	1,252	1,761	271	631	991	1,482	344	1,689
Domestic taxes on goods and services	556	601	866	204	449	645	690	212	849
Non-tax revenue	71	64	62	8	48	71	118	3	68
Grants	296	593	503	119	171	430	590	61	669
Current grants	1	207	45	0	0	0	47	0	78
Capital grants	296	386	459	119	171	430	543	61	591
Total expenditure and lending minus repayments	3,483	3,797	4,551	847	2,025	3,259	4,834	853	5,202
Current expenditure	2,752	2,781	3,261	656	1,629	2,422	3,450	678	3,541
Wages and salaries	1,342	1,445	1,775	363	753	1,236	1,648	452	1,806
Interest payments	159	142	343	48	107	182	250	62	300
Foreign	39	45	61	11	26	39	60	24	96
Domestic	120	97	282	37	81	143	190	39	204
Other	1,117	1,046	1,106	139	444	575	1,175	127	1,269
Goods and services[1]	150	222	262	14	79	100	167	38	262
Transfers and subsidies	968	824	844	124	365	475	1,008	89	1,007
of which: SOEs							207		325
Treasury operations (net) [1]	135	148	38	108	325	476	378	53	166
Capital expenditure	731	1,016	1,290	191	396	837	1,383	175	1,661
Domestic financed	138	302	422	3	78	84	179	20	481
Foreign financed	593	714	868	188	318	753	1,204	155	1,180
Identified financing									963
Unidentified financing									218
Overall balance (commitment basis)	-933	-593	-654	-79	-359	-594	-1,282	-58	-1,036
Overall balance (excluding recapitalization and interest rescheduling, commitment basis)						-254	-942		
Float (variation of accounts payable, - = increase)	40	-156	0	104	25	0	0	0	0
Variation of domestic arrears (- = increase)	-516	187	118	40	77	172	229	60	185
Overall balance (including grants, cash basis)	-457	-624	-772	-222	-460	-766	-1,512	-118	-1,221
Overall balance (excluding recapitalization and interest rescheduling, cash basis)						-426	-1,172		
Total financing	457	624	772	222	460	766	1,512	118	321
Foreign borrowing (residency principle)	234	310	400	203	221	403	1,137	23	113
External borrowing, Gross	297	443	591	220	298	507	1,310	94	371
Budget support loans	0	115	182	151	151	184	648	0	0
Project loans	297	328	410	69	147	323	661	94	371
Amortization on a due basis (-)	-63	-133	-192	-16	-77	-104	-173	-63	-258
Domestic borrowing (residency principle)	223	314	372	19	239	363	375	95	208
Monetary sector	428	222	327	131	383	351	340	90	224
Non-monetary sector	63	17	45	-15	-38	12	35	5	-16
Treasury correspondent accounts (net)	-268	181	0	-97	-107	0	0	0	0
Privatization proceeds	0	0	0	0	0	0	0	0	0
Excess financing (+)	0	0	0	0	0	0	0	0	-899
Prospective financing									218
Excess financing after prospective financing (+)									-682

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

[1] Projections for domestic taxes and other treasury operations net in 2016 include an amount of MGA 90bn (0.3 percent of GDP) corresponding to tax arrears of Air Madagascar used for its recapitalization.

Table 4. Madagascar: Fiscal Operations of the Central Government, 2013–16

(Percent of GDP)

	2013	2014	2015		2016[1]
	Dec	Dec	Dec		Dec
	Actuals	Prel. Est.	Budget	Projections	Projections
Total revenue and grants	10.9	12.4	13.5	12.4	13.0
Total revenue	9.6	10.1	11.7	10.3	10.9
Tax revenue [1]	9.3	9.9	11.5	9.9	10.7
Taxes on income, profits, and capital gains	1.9	2.7	2.4	2.3	2.5
Taxes on international trade and transactions	5.0	4.9	6.1	5.2	5.3
Domestic taxes on goods and services	2.4	2.3	3.0	2.4	2.6
Non-tax revenue	0.3	0.2	0.2	0.4	0.2
Grants	1.3	2.3	1.7	2.1	2.1
Current grants	0.0	0.8	0.2	0.2	0.2
Capital grants	1.3	1.5	1.6	1.9	1.8
Total expenditure and lending minus repayments	14.9	14.7	15.7	16.9	16.2
Current expenditure	11.8	10.8	11.3	12.1	11.0
Wages and salaries	5.7	5.6	6.1	5.8	5.6
Interest payments	0.7	0.6	1.2	0.9	0.9
Foreign	0.2	0.2	0.2	0.2	0.3
Domestic	0.5	0.4	1.0	0.7	0.6
Other	4.8	4.1	3.8	4.1	4.0
Goods and services	0.6	0.9	0.9	0.6	0.8
Transfers and Subsidies	4.1	3.2	2.9	3.5	3.1
of which: SOEs				0.7	1.0
Treasury operations (net) [1]	0.6	0.6	0.1	1.3	0.5
Capital expenditure	3.1	3.9	4.5	4.8	5.2
Domestic financed	0.6	1.2	1.5	0.6	1.5
Foreign financed	2.5	2.8	3.0	4.2	3.7
Identified financing					3.0
Unidentified financing					0.7
Overall balance (commitment basis)	-4.0	-2.3	-2.3	-4.5	-3.2
Overall balance (excluding recapitalization and interest rescheduling, commitment basis)				-3.3	
Float (variation of accounts payable, - = increase)	0.2	-0.6	0.0	0.0	0.0
Variation of domestic arrears (- = increase)	-2.2	0.7	0.4	0.8	0.6
Overall balance (including grants, cash basis)	-2.0	-2.4	-2.7	-5.3	-3.8
Overall balance (excluding recapitalization and interest rescheduling, cash basis)				-4.1	
Total financing	2.0	2.4	2.7	5.3	1.0
Foreign borrowing (residency principle)	1.0	1.2	1.4	4.0	0.4
External borrowing, gross	1.3	1.7	2.0	4.6	1.2
Budget support loans	0.0	0.4	0.6	2.3	0.0
Project loans	1.3	1.3	1.4	2.3	1.2
Amortization on a due basis (-)	-0.3	-0.5	-0.7	-0.6	-0.8
Domestic borrowing (residency principle)	1.0	1.2	1.3	1.3	0.7
Monetary sector	1.8	0.9	1.1	1.2	0.7
Non-monetary sector	0.3	0.1	0.2	0.1	0.0
Treasury correspondent accounts (net)	-1.1	0.7	0.0	0.0	0.0
Privatization proceeds	0.0	0.0	0.0	0.0	0.0
Excess financing (+)	0.0	0.0	0.0	0.0	-2.8
Prospective financing					0.7
Excess financing after prospective financing (+)					-2.1

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

[1] Projections for domestic taxes and other treasury operations net in 2016 include an amount of MGA 90bn (0.3 percent of GDP) corresponding to tax arrears of Air Madagascar used for its recapitalization.

Table 5. Madagascar: Balance of Payments, 2013–20

	2013	2014	2015	2016	2017	2018	2019	2020
	Estimates	Prelim. Est.	Projections					
	(Millions of SDRs)							
Current account	-390.4	-16.8	-125.5	-117.3	-142.4	-244.8	-283.6	-298.7
Goods and services	-586.7	-302.7	-228.3	-214.6	-257.1	-369.9	-427.4	-447.3
Trade balance of goods	-539.7	-360.0	-209.7	-278.0	-318.3	-425.3	-472.9	-490.1
Exports, f.o.b.	1,283.4	1,444.8	1,571.2	1,605.5	1,730.4	1,797.7	1,928.3	2,080.3
Of which: Mining	342.4	500.0	533.5	524.2	596.0	600.3	605.2	608.6
Imports, f.o.b.	-1,823.1	-1,804.8	-1,780.9	-1,883.4	-2,048.7	-2,223.0	-2,401.2	-2,570.4
Of which: Petroleum products	-371.8	-360.5	-267.8	-296.9	-341.0	-384.7	-418.5	-445.0
Of which: Food	-227.8	-200.5	-191.8	-209.2	-215.2	-221.6	-228.7	-236.1
Of which: Intermediate goods and capital	-571.4	-585.2	-624.1	-657.6	-704.1	-752.9	-806.3	-852.6
Services (net)	-46.9	57.3	-18.6	63.4	61.2	55.4	45.5	42.8
Receipts	831.0	858.4	804.4	842.9	885.3	930.0	977.8	1,029.5
Payments	-877.9	-801.1	-822.9	-779.5	-824.1	-874.6	-932.3	-986.7
Income (net)	-221.0	-197.0	-250.3	-263.4	-266.4	-269.7	-277.0	-296.8
Receipts	11.8	9.6	10.6	11.9	13.6	15.2	16.0	16.9
Payments	-232.8	-206.5	-260.9	-275.3	-280.0	-284.9	-293.0	-313.7
Of which: interest on public debt	-11.9	-12.3	-14.4	-19.7	-25.0	-29.4	-36.3	-44.1
Current transfers (net)	417.2	482.8	353.1	360.7	381.1	394.8	420.8	445.4
Official transfers	44.5	84.7	34.0	41.1	42.7	36.4	38.8	41.0
Of which: Budget aid [1]	0.0	54.8	10.3	15.9	15.9	8.0	8.5	9.0
Of which: Other (net)	44.5	29.9	23.7	25.3	26.8	28.4	30.2	32.0
Private transfers	372.7	398.2	319.1	319.6	338.4	358.4	382.1	404.3
Capital and financial account	234.7	33.5	104.4	-53.5	94.8	115.9	142.5	182.3
Capital account	88.1	85.1	131.1	120.7	147.7	150.6	145.4	145.4
Of which: Project grant [1]	88.1	85.1	131.1	120.7	147.7	150.6	145.4	145.4
Financial account	153.7	-36.8	-7.1	-174.3	-52.9	-34.7	-2.8	36.9
Foreign direct and portfolio investment	362.8	205.7	212.8	215.5	241.6	271.7	306.8	343.8
Other investment	-209.1	-242.5	-219.9	-389.8	-294.5	-306.4	-309.7	-306.9
Government	66.6	82.7	274.5	23.1	75.9	27.4	30.8	29.8
Drawing	88.5	118.7	316.4	75.9	136.2	81.4	80.3	80.3
Project drawings [1]	88.5	88.3	159.7	75.9	136.2	81.4	80.3	80.3
Budgetary support [1]	0.0	30.4	156.6	0.0	0.0	0.0	0.0	0.0
Amortization	-21.9	-36.0	-41.8	-52.7	-60.2	-54.0	-49.5	-50.5
Monetary authority and private sector	-118.1	-114.0	-176.5	-149.0	-106.5	-99.9	-106.5	-112.8
Banks	34.8	-24.9	21.0	0.0	0.0	0.0	0.0	0.0
Other (inc. unrepatriated export revenues)	-192.5	-186.3	-338.9	-263.9	-263.9	-233.9	-233.9	-223.9
Errors and omissions	-7.1	-14.8	-19.7	0.0	0.0	0.0	0.0	0.0
Overall balance	-155.7	16.6	-21.1	-170.8	-47.6	-128.9	-141.1	-116.4
Financing	155.7	-16.6	-9.3	-51.0	-48.7	-46.4	-43.5	-46.6
Central bank (net; increase = –)	173.7	-16.6	-9.3	-51.0	-48.7	-46.4	-43.5	-46.6
Use of IMF credit (net)	-6.2	17.5	-11.8	-10.6	-8.4	-6.0	-3.1	-6.2
Other assets, net (increase = –)	179.8	-33.3	2.5	-40.4	-40.4	-40.4	-40.4	-40.4
Debt relief and cancellation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	-18.0	0.0	30.4	221.8	96.3	175.3	184.5	163.0
Financing gap [2]	0	0	30	222	96	175	185	163
	(Percent of GDP; unless otherwise indicated)							
Memorandum items:								
Grants	1.3	2.0	2.0	2.1	2.4	2.2	2.0	1.9
Loans	1.3	1.7	4.6	1.2	2.0	1.1	1.0	1.0
Direct investment	5.2	2.9	3.1	3.3	3.5	3.7	3.9	4.1
Current account								
Excluding net official transfers	-6.9	-2.2	-3.9	-3.9	-4.4	-5.5	-5.6	-5.5
Including net official transfers	-5.6	-0.2	-1.8	-1.8	-2.1	-3.3	-3.6	-3.6
Debt service (percent of exports of goods)	39.4	34.9	32.0	30.0	26.6	23.8	21.0	18.6
Gross official reserves (millions of SDR)	502	535	590	629	702	783	870	958
Months of imports of goods and nonfactor services	2.2	2.5	2.7	2.8	2.9	3.0	3.1	3.2
Exchange rate (ariary/US$, period average)	2,207	2,415	…	…	…	…	…	…

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

[1] Only includes external financial support that has been signed by the authorities.

[2] Consists of unidentified project, budget, and balance of payment support.

Table 6. Madagascar: Monetary accounts, 2013–16[1]

(Billions of Ariary; unless otherwise indicated)

	2013	2014	2015				2016	
	Dec	Dec	Mar	June	Sep	Dec	Mar	Dec
	Actuals		Prel. Est.		Proj.		Proj.	
Net foreign assets	1,840	2,159	2,310	2,169	2,324	2,816	2,815	3,235
Net foreign assets (BCM)	1,219	1,389	1,523	1,425	1,493	1,937	1,924	2,305
Net foreign assets (deposit money banks)	621	770	787	744	831	878	891	930
Net domestic assets	4,054	4,390	4,452	4,777	4,790	4,516	4,597	5,096
Domestic credit	3,943	4,582	4,702	5,079	5,228	5,362	5,451	6,102
Net credit to government	1,119	1,232	1,379	1,631	1,612	1,595	1,690	1,828
BCM	430	652	731	909	1,028	1,051	1,068	1,056
DMBs	431	326	380	452	300	267	340	487
Gross credits (mainly BTAs)	810	695	802	825	697	662	735	881
Deposits	-379	-369	-422	-374	-397	-394	-394	-394
Other credits	258	254	268	270	283	277	282	285
Credit to the economy	2,824	3,350	3,322	3,449	3,616	3,767	3,761	4,274
Credit to public enterprises	54	79	82	99	100	82	82	82
Credit to private sector	2,745	3,250	3,233	3,335	3,508	3,677	3,671	4,184
Other credits	25	21	8	15	8	8	8	8
Other items (net)	111	-184	-250	-302	-438	-846	-854	-1,006
BCM	906	774	726	584	430	156	132	35
Other	-795	-965	-976	-887	-868	-1,001	-986	-1,041
Money and quasi-money (M3)	5,894	6,549	6,762	6,946	7,113	7,332	7,412	8,331
Foreign currency deposits	666	809	828	838	917	969	982	1,025
Short term obligations of commercial banks	36	43	42	41	41	43	41	43
Broad money (M2)	5,191	5,698	5,892	6,067	6,156	6,321	6,389	7,263
Currency in circulation	1,608	1,826	1,781	1,837	1,925	2,008	1,952	2,281
Demand deposits in local currency	1,945	2,087	2,220	2,135	2,212	2,342	2,410	2,725
Quasi-money including time deposits	1,638	1,786	1,891	2,095	2,018	1,971	2,026	2,257
	(Percentage change relative to broad money at beginning of the year)							
Net foreign assets	-15.8	6.1	2.7	0.2	2.9	11.5	0.0	6.6
Net domestic assets	22.0	6.5	1.1	6.8	7.0	2.2	1.3	9.2
Domestic credit	18.9	12.3	2.1	8.7	11.3	13.7	1.4	11.7
Net credit to government	10.8	2.2	2.6	7.0	6.7	6.4	1.5	3.7
Credit to the economy	8.1	10.1	-0.5	1.7	4.7	7.3	-0.1	8.0
Credit to public enterprises	0.0	0.5	0.0	0.4	0.4	0.0	0.0	0.0
Credit to private sector	8.1	9.7	-0.3	1.5	4.5	7.5	-0.1	8.0
Other items (net; asset = +)	3.2	-5.7	-1.1	-2.1	-4.5	-11.6	-0.1	-2.5
	(Percentage change year-on-year)							
Broad money (M2)	9.0	9.8	13.0	14.2	16.6	10.9	8.4	14.9
Currency in circulation	6.0	13.6	16.2	12.9	16.3	10.0	9.6	13.6
Demand deposits in local currency	3.9	7.3	14.1	11.8	16.0	12.2	8.6	16.3
Quasi-money in local currency	19.3	9.0	9.0	18.1	17.5	10.4	7.1	14.5
Credit to the private sector (in nominal terms)	16.2	18.4	18.1	16.0	18.3	13.2	13.6	13.8
Credit to the private sector (in real terms)	10.0	12.4	...	...	...	5.2	...	6.6
Memorandum items:								
Money multiplier (M3/reserve money)	2.40	2.34	2.43	2.40	2.40	2.36	2.47	2.40
Velocity of money (GDP/end-of-period M3)	3.97	3.94	3.92	3.92	3.92	3.90	3.98	3.85

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

[1] End of period.

Table 7. Madagascar: Balance Sheet of the Central Bank, 2013-16[1]

(Billions of Ariary; unless otherwise indicated)

	2013	2014	2015				2016	
	Dec	Dec	Mar	June	Sep	Dec	Mar	Dec
	Actuals		Prel. Est.			Proj.	Proj.	
Net foreign assets	1,219	1,389	1,523	1,425	1,493	1,937	1,924	2,305
Gross foreign assets	1,734	2,013	2,155	2,070	2,189	2,820	2,793	3,184
Gross foreign liabilities	-515	-624	-632	-644	-696	-882	-869	-879
Net domestic assets	1,234	1,410	1,266	1,465	1,466	1,165	1,073	1,166
Credit to government (net)	430	652	731	909	1,028	1,051	1,068	1,056
Claims on central government	541	919	862	982	1,089	1,151	1,168	1,156
Statutory advances	33	366	311	307	371	231	248	265
Securitized debt (T-bonds and bills)	338	338	532	532	532	735	735	711
Discounted bills of exchange	87	19	18	17	60	60	60	60
Other credits	82	195	2	126	126	124	124	120
Government deposits	-111	-267	-131	-72	-61	-100	-100	-100
Claims on other sectors	9	8	9	9	7	8	7	7
Claims on banks: Liquidity operations (+ = injection)	-111	-24	-201	-38	0	-49	-134	68
Other items (net; asset +)	906	774	726	584	430	156	132	35
Reserve money	2,453	2,799	2,788	2,890	2,958	3,102	2,997	3,471
Currency outside banks	1,608	1,826	1,781	1,837	1,925	2,008	1,952	2,281
Bank reserves	844	972	1,006	1,052	1,032	1,094	1,044	1,190
Currency in banks	153	170	119	146	122	161	130	178
Deposits	691	802	887	907	910	933	914	1,011
			(Cumulative annual flows)					
Memorandum items:								
Net foreign assets	-624	170	134	36	103	548	-13	368
Millions of SDRs	-174	16	14	-17	-40	36	-8	50
Net domestic assets	465	176	-144	55	56	-245	-92	1
Credit to government (net)	271	222	80	258	377	399	17	5
Reserve money	-159	346	-11	92	159	303	-105	369
			(Millions of SDRs)					
Net foreign assets	353	369	383	352	330	405	397	455

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

[1] End of period.

Table 8. Madagascar: Projected External Borrowing, 2015Q3-16Q3

Public and Publicly-Guaranteeed External Debt	Volume of new debt in 2015/16	
	US$ million	Percent
By sources of debt financing	**540.8**	**100**
Concessional debt, of which	**340.8**	**63**
Multilateral debt	316.6	59
Bilateral debt	24.2	4
Other	0.0	0
Non-concessional debt, of which	**200.0**	**37**
Semi-concessional	120.0	22
Commercial terms	80.0	15
By Creditor Type	**540.8**	**100**
Multilateral	316.6	59
Bilateral - Paris Club	84.2	16
Bilateral - Non-Paris Club	60.0	11
Other	80.0	15
Uses of debt financing	**540.8**	**100**
Infrastructure	161.3	30
Social spending	152.8	28
Budget financing	166.7	31
Other	60.0	11

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

Table 9. Madagascar: Selected Financial Soundness Indicators, 2009-15[1]

(Ratios, percent)

	2009 Dec	2010 Dec	2011 Dec	2012 Dec	2013 Dec	2014 Dec	2015 Mar	2015 June
Capital Adequacy								
Regulatory capital to risk-weighted assets	14.6	14.4	15.3	15.2	14.7	13.3	13.4	13.5
Capital to assets	7.1	7.4	7.2	7.2	7.9	7.7	7.3	7.7
Regulatory Tier 1 capital to risk-weighted assets	14.8	14.9	16.2	15.9	15.0	13.6	14.0	14.1
Tier 1 to assets	7.2	7.6	7.6	7.6	8.0	7.9	7.6	8.0
Non-performing loans net of provisions to capital	20.2	19.2	18.0	13.5	17.7	17.3	17.2	15.4
Net open position in equities to capital	6.6	6.3	6.8	6.0	6.5	7.6	7.5	8.3
Asset Quality								
Non-performing loans to total gross loans	11.3	13.1	14.6	14.2	13.8	12.0	11.8	11.5
Earnings and Profitability								
Return on assets	1.6	1.5	1.8	2.0	2.3	3.1	3.7	3.8
Return on equity	21.9	19.9	22.9	25.4	29.1	38.1	35.3	36.3
Interest margin to gross income	60.7	62.1	63.2	63.6	63.9	58.8	57.2	56.8
Non-interest expenses to gross income	50.9	52.3	52.8	56.0	54.2	48.0	46.4	46.8
Trading income to total income	97.5	97.9	97.4	97.7	97.5	97.7	98.0	98.0
Personnel expenses to non-interest expenses	36.6	37.7	37.2	38.4	39.5	41.3	41.3	40.6
Liquidity								
Liquid assets to total assets (liquid asset ratio)	46.9	45.9	49.7	50.4	43.2	39.9	43.6	40.8
Liquid assets to short-term liabilities	69.7	67.8	71.0	74.1	63.7	58.9	64.9	60.9
Customer deposits to total (non-interbank) loans	183.5	175.0	188.2	188.3	158.2	145.8	154.2	151.5
Sensitivity to Market Risk								
Net open position in foreign exchange to capital	15.4	15.1	14.5	11.9	17.1	8.9	8.2	7.8
Spread between reference lending and deposit rates	10.6	11.2	11.6	11.9	12.5	12.0	11.4	23.1
Foreign currency-denominated loans to total loans	4.9	4.7	7.3	5.9	6.3	5.3	4.8	5.3
Foreign currency-denominated liabilities to total liabilities	17.8	19.3	18.3	17.5	16.3	17.6	16.9	16.5

Sources: Malagasy authorities.

[1] Ratios only concern banking sector.

Table 10. Madagascar: Indicators of Capacity to Repay the Fund, 2015-25

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
					(Millions of SDRs)						
Fund obligations based on existing credit											
Principal	0.0	10.6	8.3	5.9	3.1	6.1	6.1	6.1	6.1	3.1	0.0
Charges and interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund obligations based on existing and prospective credit											
Principal	0.0	10.6	8.3	5.9	3.1	6.1	12.2	12.2	12.2	9.2	6.1
Charges and interest	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.1	0.1	0.1	0.0
Total obligations based on existing and prospective credit											
Millions of SDRs	0.0	10.6	8.3	5.9	3.2	6.3	12.4	12.3	12.3	9.2	6.2
Billions of Ariary	0.0	52.1	42.6	31.7	17.9	36.3	73.9	75.9	78.0	60.2	41.4
Percent of exports of goods and services	0.0	0.4	0.3	0.2	0.1	0.2	0.4	0.3	0.3	0.2	0.1
Percent of debt service	0.0	9.3	7.3	5.3	2.5	4.7	9.9	8.3	7.3	4.7	2.8
Percent of GDP	0.0	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Percent of government revenue	0.0	1.5	1.1	0.7	0.3	0.6	1.1	1.0	0.9	0.6	0.4
Percent of quota	0.0	8.7	6.8	4.8	2.7	5.1	10.1	10.1	10.1	7.6	5.0
Outstanding IMF credit based on existing and prospective drawings											
Millions of SDRs	85.9	75.2	67.0	61.1	58.0	51.9	39.7	27.5	15.3	6.1	0.0
Billions of Ariary	355.4	368.4	344.5	327.0	321.3	299.8	237.4	169.1	96.7	39.8	0.0
Percent of exports of goods and services	3.6	3.1	2.6	2.2	2.0	1.7	1.2	0.8	0.4	0.1	0.0
Percent of debt service	84.0	65.9	59.0	55.2	44.9	38.9	31.7	18.5	9.0	3.1	0.0
Percent of GDP	1.2	1.1	1.0	0.8	0.7	0.6	0.4	0.3	0.2	0.1	0.0
Percent of government revenue	12.0	10.5	8.6	7.1	6.1	4.9	3.4	2.2	1.1	0.4	0.0
Percent of quota	70.3	61.6	54.8	50.0	47.5	42.5	32.5	22.5	12.5	5.0	0.0
Net use of IMF credit (millions of SDRs)	30.6	-10.6	-8.3	-5.9	-3.1	-6.1	-12.2	-12.2	-12.2	-9.2	-6.1
Disbursements	30.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.0	10.6	8.3	5.9	3.1	6.1	12.2	12.2	12.2	9.2	6.1
Memorandum items:					(Billions of Ariary, unless otherwise indicated)						
Exports of goods and services (millions of SDRs)	2,376	2,448	2,616	2,728	2,906	3,110	3,320	3,554	3,812	4,097	4,410
Debt service	423.2	558.6	584.3	592.7	715.9	770.4	749.5	915.3	1,074.9	1,280.4	1,499.2
Nominal GDP (at market prices)	28,618	32,055	35,602	39,313	43,349	47,850	52,755	58,163	64,126	70,700	77,948
Government revenue	2,961	3,497	4,029	4,627	5,305	6,106	6,943	7,771	8,696	9,729	10,882
Quota (millions of SDRs)	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2	122.2

Source: IMF staff estimates and projections.

Table 11. Madagascar: Millennium Development Goals[1]

	1990	1995	2000	2005	2012	2015 target	Status [2]
Goal 1: Eradicate extreme poverty and hunger							**Low progress**
Employment to population ratio, 15+, total (%)	84	84	85	84	86		
Employment to population ratio, ages 15-24, total (%)	71	71	73	72	75		
GDP per person employed (constant 1990 PPP $)	1,714	1,441	1,494	1,426	1,348		Medium progress
Income share held by lowest 20%	...	6	5	6	5		
Malnutrition prevalence, weight for age (% of children under 5)	36	30	...	37	...	19	Unlikely to meet
Poverty gap at $1.25 a day (PPP) (%)	...	33	41	27	43		
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	...	72	76	68	81	35	Unlikely to meet
Vulnerable employment, total (% of total employment)	...	84	...	86	...		
Goal 2: Achieve universal primary education							**Low progress**
Literacy rate, youth female (% of females ages 15-24)	...	...	68	...	...	100	Unlikely to meet
Literacy rate, youth male (% of males ages 15-24)	...	...	73	...	...	100	Unlikely to meet
Persistence to last grade of primary, total (% of cohort)	34	27	36	36	41	100	Unlikely to meet
Primary completion rate, total (% of relevant age group)	35	31	36	58	70	100	Unlikely to meet
Adjusted net enrollment rate, primary (% of primary school age children)	67	56	65	77	...	100	Unlikely to meet
Goal 3: Promote gender equality and empower women							**High progress**
Proportion of seats held by women in national parliaments (%)	...	4	8	7	18	50	Likely to meet
Ratio of female to male primary enrollment (%)	96	104	96	96	99	100	Likely to meet
Ratio of female to male secondary enrollment (%)	94	...	...	96	95	100	Likely to meet
Ratio of female to male tertiary enrollment (%)	77	83	87	89	92	100	Likely to meet
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	...	31	...	38	35	50	Medium progress
Goal 4: Reduce child mortality							**Low progress**
Immunization, measles (% of children ages 12-23 months)	47	55	57	74	69	100	Unlikely to meet
Mortality rate, infant (per 1,000 live births)	97	85	69	54	41	31	Unlikely to meet
Mortality rate, under-5 (per 1,000 live births)	159	137	109	81	58	53	Unlikely to meet
Goal 5: Improve maternal health							**Medium progress**
Adolescent fertility rate (births per 1,000 women ages 15-19)	150	153	152	140	125		Medium progress
Births attended by skilled health staff (% of total)	57	47	46	51	...		Medium progress
Contraceptive prevalence (% of women ages 15-49)	17	19	19	27	...		Medium progress
Maternal mortality ratio (modeled estimate, per 100,000 live births)	640	550	400	310	240	122	Unlikely to meet
Pregnant women receiving prenatal care (%)	78	77	71	80	...	100	Medium progress
Unmet need for contraception (% of married women ages 15-49)	32	26	...	24	...		Medium progress
Goal 6: Combat HIV/AIDS, malaria, and other diseases							**Medium progress**
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	...	...	61	34	...		Low progress
Incidence of tuberculosis (per 100,000 people)	391	335	293	262	234		Medium progress
Prevalence of HIV, female (% ages 15-24)	...	...	...	...	0		
Prevalence of HIV, male (% ages 15-24)	...	...	...	...	0		
Prevalence of HIV, total (% of population ages 15-49)	0	1	1	1	1		Medium progress
Tuberculosis case detection rate (%, all forms)	14	48	35	40	49		Medium progress
Goal 7: Ensure environmental sustainability							**Medium progress**
Forest area (% of land area)	24	23	23	22	22		
Improved sanitation facilities (% of population with access)	8	9	11	12	14	54	Unlikely to meet
Improved water source (% of population with access)	29	34	38	42	48	68	Unlikely to meet
Goal 8: Develop a global partnership for development							
Net ODA received per capita (current US$)	34	22	20	50	20		
Debt service (PPG and IMF only, % of exports of goods, services and primary income)	44	7	7	5	3		High progress
Internet users (per 100 people)	0	0	0	1	2		Medium progress
Mobile cellular subscriptions (per 100 people)	0	0	0	3	39		High progress
Telephone lines (per 100 people)	0	0	0	1	1		Medium progress

Source: World Bank, *World Development Indicators* (October 2013).

[1] Figures may refer to the most recent period available, other than those specified in the header.

[2] Status according to "Enquête Nationale sur le Suivi des Objectifs du Millénarie pour le Développement à Madagascar", report published in 2014 by l'Institut National de la Statistique (INSTAT) in cooperation with les Partenaires Techniques et Financiers. The report, based on data for 2012-13, is available on www.instat.mg

Appendix I. Letter of Intent

Antananarivo, Madagascar
November 4, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431 USA

Dear Madam Managing Director:

1. We have continued our program of recovery from the transition period. Our policy measures in 2015 have aimed to strengthen our macroeconomic stability and sustainability in support of durable poverty reduction and growth. Despite a difficult external environment and deep-rooted structural weaknesses, we have made progress this year.

2. These policies mark the launch of a medium-term economic reform program. Durable poverty reduction and growth will call for significantly increased investment, which in turn will require improved mobilization of domestic revenue and will lead to a protracted balance of payments need. To assist us in this effort, we are counting on the financial support of the international community, which is needed if our efforts are to succeed in materially improving living standards in the next few years. We are asking the International Monetary Fund to provide immediate support in the form of a disbursement under the Rapid Credit Facility (RCF) in an amount equivalent to 25 percent of quota, or SDR 30.55 million that would be disbursed to the Central Bank of Madagascar.

3. The attached Memorandum of Economic and Financial Policies (MEFP) describes the policies that we have implemented this year, as well as those we plan to implement both over the next six months and all next year. The policy plans for the next six months will also form the basis of a staff-monitored program, which is intended to help lay the groundwork for a multi-year program supported by the Extended Credit Facility (ECF). The government is convinced that the policies and measures included in this memorandum will help to address our balance of payment difficulties and advance our poverty reduction and growth objectives. We stand ready to take any further measures that may prove necessary to meet our objectives and will consult with IMF staff prior to the adoption of any changes to the policies set forth in this Memorandum. The government also undertakes to cooperate fully with the IMF to achieve its policy objectives and not to introduce measures or policies that would compound Madagascar's balance of payment difficulties. The Central Bank of Madagascar is committed to provide timely monitoring information and undergo a safeguards assessment update, if required.

4. The Malagasy authorities agree to the publication of this Letter of Intent (LOI) and the attached MEFP and Technical Memorandum of Understanding (TMU), as well as the IMF staff report related to the request for a disbursement under the Rapid Credit Facility (RCF) and the Debt Sustainability Analysis, after approval by the Executive Board of the IMF.

Sincerely yours,

/s/

Mr. François Marie Maurice Gervais Rakotoarimanana
Minister of Finance and Budget
Madagascar

/s/

Mr. Alain Hervé Rasolofondraibe
Governor
Central Bank of Madagascar

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

Attachment I. Memorandum of Economic and Financial Policies

I. Overview

1. **This memorandum of economic and financial policies lays out the reform program of the Government of the Republic of Madagascar for the remainder of 2015 and 2016 in connection with a request for a disbursement under the Rapid Credit Facility (RCF), as well as a staff-monitored program (SMP).** Recurring cycles of political instability have hindered economic and social development in Madagascar over the last fifty years. As a result, real per capita GDP has been declining with widespread and growing poverty. During the latest 2009-13 crisis, average real GDP growth was reduced to ½ percent a year, significantly below population growth of 2.8 percent a year. This crisis period resulted in the stalling of efforts to improve the rule of law and public sector efficiency and governance deteriorated.

2. **The government is now promoting an agenda of consensus, reconciliation, and the restoration of governance.** The emphasis is on improving physical and human capital, strengthening governance and the rule of law, and thereby creating the foundation for inclusive growth benefiting all income levels and regions. The government's strategic direction is stated in the National Development Plan (NDP), covering 2015-19, and the Presidential Plan of Urgent Action (PPUA), covering 2015-16. The NDP and the PPUA together identify five unifying and complementary strategic priorities: (i) governance, rule of law, security, decentralization, democracy, and national solidarity; (ii) preservation of macroeconomic stability and support for development; (iii) inclusive growth and territorial anchoring of development; (iv) adequate human capital for the development process; and (v) development of natural capital and strengthening resilience to disaster risk.

3. **Our policy measures in 2015 have aimed to strengthen our macroeconomic stability and sustainability in support of durable poverty reduction and growth**. Despite the constraints of political developments and external shocks, we have made some progress this year. But meaningful improvement in physical and human capital will call for significantly increased investment, which will require improved mobilization of domestic revenue and lead to a protracted balance of payments need.

4. **These policies mark the launch of a medium-term economic reform program**. We would like this program to be supported by a scaling up of external assistance and, eventually in the future by a three-year Extended Credit Facility (ECF) arrangement. With these objectives in view, we will continue to build our policy implementation capacity and address institutional weaknesses. In particular, we are prioritizing measures to improve revenue performance and control financial losses in state-owned enterprises and related arrears. Accordingly on the basis of the policies undertaken so far and the policy objectives laid out below, we are now requesting a disbursement under the RCF of SDR 30.55 million, combined with a staff-monitored program for the period end-September

2015 to end-March 2016. We also met with development partners in October to discuss financing needs and intend to convene a conference next year to request medium-term financing for implementing the NDP.

A. Economic Developments in 2014 and 2015

5. **Notwithstanding exogenous shocks, the policies undertaken in 2014 and 2015 have supported macroeconomic stability, while laying the groundwork for future progress.** Fiscal and current account deficits have remained compatible with medium-term sustainability, and inflation remains in single digits. However, the nascent economic recovery that started in 2014 has so far failed to gain momentum. Mining production is held back by low commodity prices. Agriculture was negatively affected by cyclones with heavy rains in the central highlands in early 2015, which displaced 39,000 people, and prolonged drought in the south, with food assistance given to 200,000 people. Damage from the cyclones and other weather-related events is estimated at 1 percent of GDP with reconstruction costs projected at close to 3 percent of GDP or US$270 million. Tourism has been hampered by difficulties at Air Madagascar, especially a crippling month-long strike in July that grounded nearly all domestic flights. In addition, weaknesses in the business climate continue to inhibit private investment. On the positive side, the decline in fuel prices is reducing the cost of petrol imports. Against this background, the projected economic growth has been revised downward to 3.2 percent in 2015.

6. **The government has taken measures to improve revenue mobilization and strengthen expenditure management, although results have so far yielded less than expected.** Institutional capacity constraints, including, in some cases, difficulties in ensuring compliance, are holding back the results of public sector reforms. The government has engaged in wide-ranging reform measures to improve tax and customs administration, however revenue collections remain weak with adverse fiscal implications. While we have been able to keep priority social spending in line with plans through reprioritization, larger-than-expected transfers to loss-making public enterprises (in particular the public utility company JIRAMA and Air Madagascar) and the underfunded pension funds continue to crowd out domestic capital spending. We identified and reached agreement on a repayment schedule for previously accumulated domestic budgetary arrears in 2014, but new arrears have accumulated on VAT refunds and payments to JIRAMA's suppliers. We remain determined to resolve these institutional weaknesses in order to create a solid foundation for strong inclusive growth and durable poverty reduction.

7. **We are moving forward with macroeconomic and structural reforms notwithstanding capacity constraints:**

- *Policy strategy*. The NDP and the PPUA, which provide the framework for policy formulation going forward, were approved by the Cabinet in late 2014. The implementation plan (*Plan de mise en œuvre*, PMO), which implements the NDP and the PPUA, was approved in June.
- *Revenue mobilization*. The customs administration has drawn up a list of emergency measures to deter fraud, including a significant tightening of controls at the main port of Toamasina and an increase in the number of ex post verifications. The tax administration is focused on enhancing

compliance through improved controls and verifications, the recovery of tax arrears, and increased information sharing and collaboration with customs services. Cooperation between the customs and tax administrations has improved, though it is taking some time to translate into stronger revenue numbers. The suspension of duties and taxes for petroleum imports for non-JIRAMA related oil imports was removed in March 2015.

- *Public expenditure management.* Steps are underway to generate cost savings and improve expenditure management: specifically the public payroll is being cleaned from ghost workers and JIRAMA has taken steps to minimize its operational losses and the subsequent need for large budgetary transfers. Transfers to JIRAMA have fallen from 1.7 percent of GDP in 2014 to a projected 0.6 percent this year, aided by the fall in international fuel prices. The issuance of the implementation decree of law 2014-14 on public enterprises with commercial character has clarified the role of the state in the management of public enterprises.
- *Fuel subsidies*. Fuel prices have been increased three times between July 2014 and July 2015. These adjustments and the fall in world fuel prices have cut the cost of fuel subsidies from 0.4 percent of GDP in January-July 2014 to 0.1 percent for the same period this year.
- *Debt management and project appraisal capacity*. A steering committee on investment priorities, under the leadership of the Prime Minister, was established in March 2015. The committee will develop a priority investment plan with projects that are needed to attain the NDP objectives.
- *Central bank operations*. As part of the process to improve governance and management at the central bank, overdue interest payments owed to the central bank of about 0.4 per-cent of GDP were settled by the government in June, the central bank's audited financial statements for 2010-13 have been published, new investment guidelines were approved in December 2014, and a new directive on reserve management was approved in February 2015.
- *Foreign exchange operations*. Since September the central bank has discontinued buyback operations at non-market rates in the interbank foreign exchange market, which had influenced the official published rate based on the weighted average of transactions. It has also started publishing daily minimum and maximum exchange rates, in addition to the reference rate.
- *Monetary policy*. The central bank reintroduced weekly deposit auctions in April to improve bank liquidity management.
- *Business-climate*. We have initiated measures to strengthen the foundation for sustained private sector development. In this regard, Madagascar has regained eligibility to preferential access to US markets through AGOA; established a formal platform for public-private dialogue with the private sector; and restructured and rejuvenated the Economic Development Board of Madagascar (EDBM). We have adopted the implementation decree for the *Zone Franche*.

II. Fiscal Policy and Debt Management

8. **Fiscal policy will be geared towards supporting the implementation of the PPUA and the NDP.** We will increase spending on critical infrastructure, education, and health care to rebuild Madagascar's physical and human capital. We will also invest in rural development. Fiscal space for these priorities will be created through adjustments to tax policy, further efforts in tax and customs administration, and expenditure reprioritization. Starting in 2015 with the expansion of the Ivato airport and the transfer of a power plant to a private operator, we are exploring public-private

partnerships (PPPs) as a means to finance large infrastructure projects. In addition, to make better use of scarce budgetary resources, we will focus more on prioritization and public financial management reforms.

9. **We estimate that the tax ratio (on a gross/net basis) will increase from 10.1/9.9 percent of GDP in 2014 to around 11.0/10.4 percent of GDP in 2016.** In 2015, revenue gains from the tax policy and revenue administration measures are expected to be partly offset by the more subdued pace of economic activity and imports, resulting in a net tax ratio that is broadly unchanged from 2014.The overall deficit on a cash basis is projected at 5.3 percent of GDP in 2015. However, the fiscal deficit for 2015 includes the recapitalization of the central bank and rescheduling of interest arrears for an amount equivalent of 1.2 percent of GDP. To assist in the implementation of our reform plans in the staff monitored program, we will set targets on net claims on government by the banking system (ceiling), gross tax revenue (floor), and priority social spending (floor).

10. **Improving revenue mobilization remains a key objective.** Our overall revenue mobilization strategy seeks to break out of this revenue underperformance with a focus on strengthening revenue administration to boost taxpayer compliance in line with the findings of recent technical assistance (TA) and the Tax Administration Diagnostics Assessment Tool (TADAT). We also plan to restructure the tax administration and develop communication strategies to improve the quality of services to tax payers.

11. **To enhance revenue collections, we launched several specific tax and customs administration measures in September and October**. Among other measures, these include:

- Stricter monitoring and auditing of the declared value and nature of imports, especially for consolidated load cargo;
- Improved customs control measures to limit the abuse of exemption rules, including those on imported rice, and special regimes such as those relating to Export Processing Zones (EPZs) and temporary imports;
- Set up remote audit teams with the mission to undertake ex-post verifications focused on highly suspected fraud operations (benchmark, Table 2);
- Efforts for the recovery of arrears on domestic taxes and customs duties and taxes;
- Generation of a consistent and comprehensive list of all beneficiaries of tax exemptions to cross-check it against our taxpayer database to identify firms that claim benefits fraudulently;
- Strengthening the efforts of the joint committee to coordinate customs and tax collection efforts, including the organization of joint working groups to identify targets for control. (The creation of a tax policy coordination unit in 2016 is also being studied.)

12. **Bringing informal activity into the formal sector is essential.** Since 2014 we have initiated the following measures: repression of sales without invoices; increased controls on the ground; improved taxation of forestry, mining and fisheries sectors; harmonization of administrative values for transactions on property and second-hand vehicles; stricter controls on VAT refund credits; recovery of tax arrears; and transfer pricing adjustments. We have abolished, effective end-December 2015, all duty-free shops, except those located in our international airport departure

terminals. Enhancing the efficiency of tax audits, including through greater risk-based management, is also a priority.

13. **Customs administration reforms will continue and aim to balance revenue mobilization and trade facilitation.** In the near term, we will step up efforts to increase the effectiveness of verifications and reduce fraud. Starting in March 2015, we have increased scanning of imported containers at the port of Toamasina and set up an ancillary team in Antananarivo for secondary follow-up verifications. Other measures in 2015 include mandatory packing lists for all containers, increased use of tablets during physical inspections to optimize use of our databases, further securitization of the port perimeters through greater electronic monitoring and use of surveillance cameras, and acceleration of procedures for auction of containers which remain unclaimed. In addition, we plan to double the amount of audits on the declared value of imports from 6 to 12 percent and continue to improve our in-house database on reference import values and risk-management analysis starting with the port of Toamasina.

14. **Information sharing and collaboration between the customs and tax directorates will be further strengthened.** The customs directorate has developed an information sharing platform to enable automatic sharing of data in ASYCUDA with the tax administration twice daily. We have started joint training sessions for the staff of both directorates and identified 20 large enterprises on which verifications will be conducted jointly in 2015, and continuing annually. The customs directorate will also act as the collection agent for the intermittent income tax to enable more expedient processing. In addition, an update of estimated tax exemptions and expenditures, with the intention of later extending it from domestic taxes to customs, is planned.

15. **Ensuring an appropriate contribution from the natural resource sector to fiscal revenue is a priority.** We are working to modernize the mining and petroleum codes to bring them in line with best practice, while ensuring their consistency with the statutes of the existing law on large mining investments (LGIM). The principal envisaged measures of the codes and their associated *Décret d'Application* include: an increase in royalty rates and more differentiation by type of mineral; a review of the royalty revenue-sharing formula; simplification of the corporate income tax regimes; a tightening of thin capitalization rules; and a reduction in the length of fiscal stability clauses.[15] In order to accomplish this, we have set up a joint committee comprising officials from the Ministry for Strategic Resources, the chamber of mines, the association of mining operators, and the Ministry of Finance and Budget. We plan to finalize the draft laws, with input from the World Bank, and ensure that their provisions comply with international best practice before submitting them to the National Assembly. We plan to incorporate all the fiscal provisions of the mining and petroleum codes with the General Tax Code through amendments to be undertaken by the end of December 2015.

[15] For large mining projects, the length of the fiscal stability remains as specified under the LGIM.

16. **Moreover, the institutional framework for mining activities will be revamped.** In this regard, we seek to update the status of 3,600 mining permits to redress irregularities that arose following the 2009 moratorium on the award and conversion of permits. We have processed 1,800 permits to date and anticipate that the update will be completed by the end of-March 2016. We adopted a decree setting up a national gold agency (ANOR) in April 2015 which will be responsible for collecting gold mining royalties and administering permits for gold mining activities. In parallel with the preparation of a decree lifting the ban on gold exports, we have set up gold counters to purchase existing stocks of mined gold from individuals. To further formalize and expand gold mining activities, the central bank and Ministry for Strategic Resources will jointly complete a feasibility study by the end of December-2015 for the setting up of a public-private refining company which will be tasked with certifying the gold exported from Madagascar.

17. **We are committed to addressing the causes of spending inefficiencies and budgetary pressures.** Fuel subsidies, transfers to state-owned enterprises including JIRAMA, and the underfunded civil service pension funds are weighing heavily on budget execution. We intend to use the additional fiscal space created to reorient current spending to priority social sectors. We foresee the following measures and savings in 2015 and 2016:

- Cost savings from deferred recruitment because of insufficient absorptive capacity; prioritization of spending, including domestically-financed investment; and a reduction in the amount of fuel coupons (‘*chèques carburants*’), with a view to their elimination.
- Elimination of the fuel price subsidy, which is falling with world market prices, by the end of-December 2015. An automatic pricing formula for maintaining full cost-recovery fuel prices (for diesel, gasoline, and kerosene) will be introduced on January 1, 2016 (continuous benchmark, starting at the end of-December 2015, Table 2). The temporary bus subsidy, introduced to mitigate the price impact from higher fuel prices, will cease at end-December 2016.
- Oversight of state-owned enterprises will be strengthened, starting with financially challenged public enterprises, through ensuring compliance with the implementation decree of law 2014-14 on public enterprises with commercial character, for example by requiring the regular communication of financial results, independent control functions, and fully accountable Boards. Reform strategies have been developed for two of the larger and most strategically important public enterprises—Air Madagascar and JIRAMA—which are described below.
- Underfunding of pension funds will be addressed through a two-pronged approach, focusing first on a clean-up of the pension rolls and second on parametric pension reforms, the latter supported by World Bank technical assistance in 2015 and 2016. We plan to put in place such parametric reforms by the end of 2016.
- Extension of the audit of civil service personnel and pay data housed at the Ministry of Finance and Budget to sectoral ministries. The first audit, started in 2015, identified 2,256 irregular workers (e.g., so-called ghost workers and double-dippers) dispersed across various ministries, providing wage bill savings of MGA1.3 billion per month. We expect further cost-savings from this exercise. Installation of an electronic platform for workforce planning (“*Gestion Prévisionnelle des Effectifs, des Emplois et Compétences*”) is expected to be completed by December 2016, with support from the European Union. This, in turn, is envisaged to pave the way for a more

comprehensive civil service census. We will also initiate an evaluation of the effectiveness of the current sanctions system, including the *Conseil de Discipline de la Fonction Publique* by the end of March 2016. These measures will enhance the productivity of the civil service while reducing the public sector wage bill as a proportion of GDP.

18. **The 2016 budget will seek to consolidate policy efforts underway in 2015 and introduce measures in line with the priorities identified in the NDP**. Beyond the objective to increase revenues, fiscal policy measures will aim to tackle income tax evasion and protect local rice production. Thus, we will introduce the following revenue measures in the draft revisions to the 2015 budget and the draft 2016 budget: elimination of the tax holiday on new companies; introduction of a uniform ten percent excise duty on all imported new vehicles; an increase in excise duties on alcoholic beverages and soft drinks; and ensure that local sales of EPZ companies are restricted to 5 percent of total sales and that they are subject to customs declaration and duties and taxes (benchmark, Table 2); the introduction of a tourist arrival fee of US$25 per visitor; and the elimination of the exemption from import duties and taxes for imported cooking oil. We also intend to reinforce the filing of income tax declarations, including for incomes below MGA250,000, and to consider the possible elimination of tax exemptions on imported rice. Consideration of the possible elimination of the rice tax exemption will be informed by a study on the damage caused by the recent climatic shocks on local rice production which will be completed by end-November 2015. On the spending side, our objective is to scale up expenditure in priority areas (agriculture, education, health and infrastructure) by at least 0.5 percent of GDP while preserving sustainability. To this end, we will continue to improve the efficiency of spending, introduce parametric pension reforms and improve the allocation of resources through the use of a medium-term expenditure framework. Our fiscal plans will yield an overall fiscal deficit (commitment basis) of around 3 percent of GDP. The draft revisions to the 2015 budget and the draft 2016 budget law incorporating these revenue measures will be submitted to the National Assembly by the end of October (prior action, Table 2).

19. **A comprehensive public financial management reform strategy will be essential to improving the efficiency of public spending.** The 2013 PEFA self-assessment highlighted the need to strengthen public expenditure management. A Priority Action Plan in public financial management for 2014-15 was developed accordingly, with TA from the IMF. We have made substantial progress on the implementation of the plan and are committed to completing the remaining actions. In particular, for 2015 the priorities are to improve expenditure prioritization, including through greater transparency and phasing-in multi-year budgeting; enhancing public procurement; and more effective payroll controls. We have requested additional TA to advance work in these areas. We are also developing a PFM reform strategy for 2016-20 with support from the African Development Bank, which will be approved by Cabinet.

20. **The occurrence of arrears is holding back the economic recovery and requires action**. Since 2009, both the central government and state-owned enterprises have accumulated a significant stock of payment arrears, including in VAT refunds, subsidies to petroleum distributors and direct payments by the Government to JIRAMA's suppliers. In accordance with the Priority Action Plan for strengthening PFM and building on recent TA from the IMF, we will develop a

strategy to stop, from January 2016, the emergence of arrears on new spending commitments by the central government for fiscal year 2016. As first steps, by December 31, 2015, we will (i) finalize the evaluation of the stock of arrears, based on a clear definition of the maximum delays of payment for the main categories of expenditures and (ii) implement the reporting procedures and the organization required to manage arrears. In addition, we will create an escrow account at the Central Bank to ring fence the resources required by VAT reimbursements starting January 1, 2016 (benchmark, Table 2). Given the high risk that arrears accumulated by the state-owned enterprises have to be paid by the central government, the Treasury will be instructing SOEs to report their arrears to suppliers and the tax administration, starting by end-December 2015 with JIRAMA, Air Madagascar, and Madarail. This exercise will be extended to all SOEs by the end of March 2016 and JIRAMA, Air Madagascar and Madarail will also be required to have a plan by this date for clearing their arrears.

21. **The government is committed to the financial turnaround and rehabilitation of JIRAMA.** A *Comité Stratégique* chaired by the Minister of Energy and Hydrocarbons, established in March 2015, will guide JIRAMA's restructuring. We have hired a consultant to develop a management improvement plan, which includes the organizational restructuring of JIRAMA, to be presented to the *Comité* by November 2015. Existing legislation will be reviewed with the intention of including JIRAMA under the provisions of commercial law and increasing penalties for electricity theft. Our strategy to improve the company's financial position is centered on reducing losses and identifying theft and fraud. A program of on-site audits of the 1,000 largest users to ensure permanent elimination of unmetered consumption (commercial losses) is expected to be completed by the end of December 2015. We are investigating the use of advanced metering for new customers to secure future revenues. JIRAMA is also undertaking measures to reduce costs, such as rehabilitating the heavy fuel oil generating units and auditing its supplier contracts.

22. **There is also an urgent need to address Air Madagascar's dire operational and financial situation, in the context of the government's new "open sky" policy.** We are committed to rebuilding our national flagship carrier to successfully compete in this new framework and to minimize the fiscal risks posed to the government. We will implement an "air access strategy" to help spur domestic and international competition by mid-2016, in support of our economic development. The company is actively seeking strategic alliances to support it going forward, and has already taken the first steps toward becoming an attractive investment partner. Management and the Board were replaced following a month-long strike over governance issues. The new team is working with the World Bank to contract external expertise to develop a new business plan for the company, including a review of the tariff structure, fleet composition, staffing level, and structure of the company. Management has also taken steps to address the company's precarious financial situation by looking for additional revenue sources and investigating the reason for the company's high operational expenses, such as by carrying out an audit of existing contracts. These measures aim to restore Air Madagascar's operational profitability by end-2016.

23. **Infrastructure investment needs in Madagascar are significant, and with limited resources, public investment projects need to be well prioritized**. The World Bank Doing

Business report flags poor energy infrastructure as a particular impediment to growth. Investment in roads, railways, seaports, and airports is also critically needed. Given the limited domestic and international resources available for such investment, careful prioritization of the most important projects is required. The steering committee on investment priorities, under the leadership of the Prime Minister and with the support of the Ministry of Economic Planning and Development and other line ministries, will develop a priority investment plan. This plan will specify a list of key projects that are needed in order to attain the objectives set out in the NDP and will include preliminary cost estimates for each project. The plan will be completed by the end of-October 2015.

24. **The scale of the infrastructure challenges makes it critical to explore all options, including Public-Private Partnerships (PPPs).** Aligned with the NDP, a list of potential PPPs has been identified. The government is committed to taking all necessary measures to minimize the budgetary risks of such arrangements. To this end, a policy and legal framework for PPPs is under preparation and planned to be enacted by the end of December 2015. We also plan to create a dedicated unit to control and manage our PPPs at the Presidency by end-2015.

25. **Borrowing and guarantees to fund Madagascar's investment needs will require careful management to ensure debt remains on a sustainable trajectory.** To ensure debt sustainability, the cost and risks associated with new loans and state-guarantees needs to be minimized. In August 2014, the National Assembly ratified the *Loi Régissant la Dette Publique et la Dette Garantie par le Governement Central (2014/12)* which clearly states the roles and objectives of the government with respect to new borrowing. A debt management strategy will be ready by no later than the end of March 2016 following the development of the list of priority investment projects and the adoption of the medium-term budgetary framework. Furthermore, starting with the 2016 budget, we will publish details on the anticipated stock and flows of the central government's public and publicly-guaranteed debt; and with the support of UNCTAD, our external debt database will be fully operational by the end of March 2016 (benchmark, Table 2).

26. **Every effort will be made to meet our considerable external financing needs on concessional terms**. Madagascar is assessed to have a moderate risk of external debt distress, and is particularly vulnerable because of the low revenue generation. Ensuring that debt is contracted on concessional terms will help to ensure debt sustainability. That said, if all possibilities for concessional external financing are exhausted, some limited medium-term and long-term non-concessional borrowing could be considered to support critical expenditure needs; in that event, we will consult in advance with IMF and World Bank staff. We will also avoid short-term external borrowing. To assist in the policy implementation in the staff monitored program, we have set on explicit indicative targets on non-concessional borrowing and short-term external borrowing.

III. Monetary and Exchange Rate Policy

27. **Monetary and exchange rate policy will aim to contain demand pressures, keep inflation in single digits, and help build an adequate reserve buffer.** In doing so, the CBM aims to give more significance to the reference interest rate and monetary policy operations going

forward. To assist in the policy implementation in the staff monitored program, we have set explicit indicative targets for net foreign assets and net domestic assets as defined in the technical memorandum of understanding. Despite balance of payments pressures, we are also aiming for a buildup in gross foreign assets to reach SDR 597 million by end-2015.

28. **The CBM will pursue a restrained monetary policy and take further steps to strengthen liquidity management.** Monetary policy has been somewhat passive in recent years, allowing for large excess bank reserves with the government increasingly resorting to statutory advances from the central bank to finance the fiscal deficit. Going forward, we will engage in further TA with the aim of setting explicit liquidity targets and using Treasury bill sales and weekly deposit auctions to achieve these targets. The reference interest rate will be allowed to fluctuate more and reflect movements in the money market.

29. **We will maintain a flexible exchange rate to ensure orderly conditions in the foreign exchange market and facilitate external adjustment over the medium term.** Going forward, CBM will focus its interventions on achieving a gradual accumulation of gross foreign assets. We will refrain from reintroducing buyback operations at non-market rates in the interbank foreign exchange market (continuous benchmark, Table 2). With the aim of improving the functioning of the foreign exchange interbank market, we will reinforce the protocols of trading in the interbank market. We are also committed to minimize any resort to administrative measures to restrict foreign exchange outflows and to ensure conformity with Article VIII obligations.

30. **Strengthening the independence of the CBM and improving its governance and controls is crucial.** The financial autonomy of the central bank has been challenged in recent years. While within legal limits, CBM extended significant credit to the government through statutory advances in 2014. In addition, petroleum subsidies in 2012-13 and uncollected accrued interest on government bonds put further pressure on financial autonomy. Independent control and audit oversight can be strengthened and the quality of external auditors needs to be enhanced. We will take several measures to deal with these issues. To further establish the independence of the central bank, we will submit a revised Central Bank Act to the Cabinet for approval by the end of December 2015 (benchmark, Table 2). The revised law will: (i) include a phased elimination of statutory advances from the central bank as a source of domestic financing down to 5 percent of ordinary revenues starting in 2018, as well as a discontinuation of securitization of statutory advances, with the objective of eliminating statutory advances by 2024 (consistent with guidance from SADC); (ii) provide an effective mechanism for the automatic transfer of central bank losses and profits to the government; (iii) establish an Audit Committee of the Board of Directors (and adopt a charter that specifies its roles and responsibilities for the oversight of internal and external audit, financial reporting, and the system of internal controls); and (iv) establish an Executive Committee (composed of the Governor and two Deputy Governors) that will propose policies to the Board of Directors and will be in charge of the day-to-day operations of the central bank. We will settle outstanding central government obligations owed to the central bank through issuance of interest-bearing instruments of a total amount of MGA 214 billion with a 20 year maturity and a 2.25 percent interest rate by the end of December 2015. As a result of this transaction and previously settled debt obligations, the

financial position of the central bank will improve. To improve reporting transparency, the CBM is in the process of migrating towards International Financial Reporting Standards (IFRS) starting with 2016 accounts, supported by TA.

IV. Financial Sector Reforms

31. **We are committed to developing our financial sector.** Our aim is to create the foundation for a strong and independent financial system that can sustain the strong inclusive growth we are aiming for. An action plan will be finalized following the completion of the Financial Sector Assessment Program (FSAP) of the IMF and the World Bank that Madagascar is currently undergoing. Pending the FSAP, we are currently focusing on: (i) improving the supervision of our foreign-owned banks through agreed memoranda of understandings with banking supervisors in countries where the headquarters of our foreign-owned banks are located (primarily France, Mauritius, and Morocco); (ii) studying the prerequisites for a possible deposit insurance scheme; (iii) finalizing a law regulating mobile banking in 2015; and (iv) completing the ongoing revision of the Financial Sector Law, including the establishment of the stock exchange, in 2016. We are also conducting a study to improve the legal/regulatory and institutional capacity needed for adequate supervision of the microfinance sector in cooperation with the World Bank.

V. Inclusive Growth

32. **National reconciliation calls for inclusive growth benefitting all citizens and all regions of Madagascar.** This objective underlies our National Development Plan and Presidential Plan of Urgent Action (PPUA). We aspire to mobilize the full potential of Madagascar's young and vibrant population and various sectors of the economy. This will require reforms that (i) improve governance; (ii) improve the quality of education and health services to strengthen the human capital base; (iii) open up for a more decentralized administration; and (iv) create the framework for a sustainable exploitation of Madagascar's abundant natural capital, while preserving our unique ecosystem for future generations.

33. **We are committed to strengthen our institutions to improve governance and create a solid foundation for private sector growth.** Corruption and weaknesses in the civil service, judiciary and security systems have resulted in inferior public service delivery and revenue collections well below expectations. Systemic reforms of government institutions are complex and take time. Key elements in controlling corruption are better regulatory system and enforcement, well-defined boundaries on government power, and effective sanctions to reprimand corrupt behavior. To send a strong signal about our commitment to combat corruption, we will look to amend the civil service law. An essential element at the heart of the fight against corruption is a strong independent and impartial judiciary and we are initiating a number of reforms to ensure that our judiciary performs this role, including regular meetings of the *Conseil Superieur de la Magistrature* that oversees performance of individual magistrates. Our efforts to improve governance will be guided by the national strategy against corruption that was launched in 2014. In recognition of the importance of improving governance, we have increased the budget allocation

for the agencies dedicated to the fight against corruption by nearly 50 percent in 2016 with the objective of reaching 0.3 percent of the budget over time.

34. **Broadening access to health care and education is a key policy objective.** To improve quality and access to schooling, we aim to expand programs for households with children and emphasize minimum job standards and training of teachers. Recruitment of so-called community teachers ("Maitres FRAM") will be based on qualifications and performance evaluation. In an effort to seek new solutions to make health services more accessible, we plan to introduce mutual insurance on a pilot basis. Developing social protection programs for the most vulnerable is also a priority. The national social protection policy under preparation will guide the design and implementation of social protection programs, including social safety nets for the poorest and most vulnerable households, and will be approved by the Cabinet by the end of December 2015 (benchmark, Table 2).

35. **Agriculture is of great importance for growth and poverty reduction.** It generates about 26 percent of GDP and the main income for about 63 percent of households. The overall challenge is to move from subsistence farming to production for domestic, regional, and international markets and reduce risks for the most vulnerable households. To support this transformation, we aim to: (i) increase investment in roads and irrigation infrastructure; (ii) increase investment in schools and training focused on agriculture; (iii) increase funding of research to develop seeds and agricultural techniques that are well adapted to Madagascar; and (iv) expand social protection programs targeting the most vulnerable subsistence farmers. To protect farmers' rights to the land they own, local land offices with the right to issue land certificates will be established in all districts of the country by end-2018.

36. **Decentralization reforms are important.** Such reforms are essential to improve the quality and access to public services and to foster local development policies through more immediate responses to the needs of citizens. We are starting reforms in 2015 by identifying and defining appropriate local government structures; implementing measures to strengthen local governance; preparing the legal framework for the local civil service; and ensuring full coherence between the existing legal and institutional frameworks for decentralization with local development plans and the NDP objectives.

VI. Statistical Policy

37. **We are committed to the production of more timely and accurate statistics to allow better assessment of developments in the country.** With support from the IMF and other development partners, the National Statistics Institute (INSTAT) is preparing a provisional and revised series of national accounts based on the 1993 *SNA* for the period of 2007-14. We want to develop satellite national accounts on mines, forests, tourism and water, to be integrated in the national accounts in 2016. As an update to the 1993 population census, we intend to undertake a new census in coming years, subject to the availability of additional financing. The CBM will continue to improve the compilation of balance of payments and monetary statistics.

Table I.1. Madagascar: Indicative Targets 2015-16

	End-Dec. 2015 Proj.	End-March 2016 Proj.
	(Billions of Ariary; unless otherwise indicated)	
External		
Ceiling on accumulation of new external payment arrears (US$ millions) [1]	0	0
Ceiling on new nonconcessional external debt with original maturity of more than one year, contracted or guaranteed by the central government or BCM (US$ millions) [1]	200	200
Ceiling on new nonconcessional external debt with original maturity of up to and including one year, contracted or guaranteed by the central government or BCM (US$ millions) [1]	0	0
Central bank		
Floor on net foreign assets (NFA) of BCM (millions of SDRs) [2]	416	407
Ceiling on net domestic assets (NDA) of BCM [2]	1,558	1,485
Fiscal		
Ceiling on net bank credit to the government [3]	340	90
Floor on social priority spending [3]	204	33
Floor on gross tax revenue [3]	2,994	746
Memorandum items		
Budget support grants and loans (millions of SDRs) [4]	119	119
New concessional loans, contracted or guaranteed by the central government or BCM (US$ millions) [5]	167	327
Program exchange rate (MGA/SDR)	3,761.88	3,761.88
Recapitalization of the central bank for losses made during 2011-13 [4]	214	214

Sources: Malagasy authorities; and IMF staff projections.

[1] Cumulative ceilings that will be monitored on a continuous basis starting from end-August, 2015.

[2] Stock of NFA and NDA respectively measured at the program exchange rate.

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

[4] Cumulative figures starting from the beginning of 2015.

[5] Cumulative figures starting from end-September, 2015.

Table I.2. Madagascar: Prior Actions and Structural Benchmarks for RCF and SMP

Action	Test Date
RCF	
Strengthen fiscal policy implementation	
Submission of draft revisions to the 2015 budget and draft 2016 budget to parliament with the revenue measures outlined in the MEFP (paragraph 18).	Prior Action
SMP	
Improve exchange rate policies	
Refrain from reintroduction of buyback operations at non-market rates.	Continuous benchmark
Mobilizing fiscal revenue	
Set up remote audit teams with the mission to undertake ex-post verifications focused on highly suspected fraud operations.	End-December 2015
Ensure that local sales of EPZ companies are restricted to 5 percent of total sales and that they are subject to customs declaration and duties and taxes.	End-March 2016
Improving the composition and quality of fiscal spending	
Implement an automatic pricing formula for maintaining full cost-recovery fuel prices (for diesel, gasoline, and kerosene).	Continuous benchmark from end-Dec. 2015
Create an escrow account at the Central Bank to ring fence the resources required by VAT reimbursements.	January 1, 2016
Improving fiscal transparency	
Bring the DMFAS database into full operation and publish details on the stock and flows of public and publically-guaranteed debt starting with the 2016 budget law.	End-March 2016
Strengthening the independence of the central bank	
Submit Central Bank Act revised to incorporate the elements outlined in the MEFP (paragraph 30) to the Cabinet for approval.	End-December 2015
Promoting inclusive growth	
Cabinet approval of the National Social Protection Policy to guide the design and implementation of social protection programs, including social safety nets for the poorest and most vulnerable households.	End-December 2015

Attachment II. Madagascar: Technical Memorandum of Understanding on Monitoring Indicative Targets for the Staff Monitored Program in 2015 and 2016

This technical memorandum of understanding (TMU) defines the indicative targets and adjustments that have been established to monitor the staff monitored program. It also describes the methods to be used to assess performance.

I. Indicative Targets

1. Targets will be set for end-December 2015 and end-March 2016 for the following variables:

- **Floor on net foreign assets (NFA)** of the Central Bank of Madagascar (CBM), calculated as the stock at program exchange rates; and
- **Ceiling on net domestic assets (NDA)** of CBM, calculated as the stock at program exchange rates; and
- **Ceiling on net bank credit (NBC)** to the Government, calculated as the cumulative flow from the beginning of the calendar year; and
- **Floor on gross tax revenue** of the central government, calculated cumulatively from the beginning of the calendar year; and
- **Floor on priority social spending** by the central government, calculated cumulatively from the beginning of the calendar year.

2. A target applicable on a continuous basis has been established with respect to a:

- **Ceiling on the accumulation of new external payment arrears** by the government or CBM calculated in cumulative terms from end-August 2015;
- **Ceiling on medium- and long-term non-concessional external debt** contracted or guaranteed by the government or CBM, calculated in cumulative terms from end-August 2015;
- **Ceiling on short-term non-concessional external debt** contracted or guaranteed by the government or CBM, calculated in cumulative terms from end-August 2015; and
- **Zero-Ceiling on CBM buyback operations at non-market rates in the interbank foreign exchange market.**

3. The adjustor to the measurement of indicative targets is budget support (external grants and loans) to the government from bilateral and multilateral agencies, calculated as the cumulative flow from the beginning of the calendar year.

4. For accounting purposes, the following program exchange rates apply:

Program Exchange Rates	
Malagasy Ariary (MGA)/SDR	3,761.88
U.S. Dollar/SDR	1.448699
Euro/SDR	1.187713
Australian dollar/SDR	1.774606
Canadian dollar/SDR	1.666667
Japanese Yen/SDR	173.119204
Swiss Franc	1.433198
U.K. Pound Sterling/SDR	0.932216

Foreign currency accounts denominated in currencies other than the SDR will first be valued in SDRs and then be converted to MGA. Amounts in other currencies than those reported in the table above and monetary gold will first be valued in SDRs at the exchange rates and gold prices that prevailed on December 31, 2014, and then be converted to MGA.

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

II. Monetary Aggregates

A. Floor on Net Foreign Assets of the Central Bank of Madagascar

6. The NFA of CBM is defined as the difference between CBM's gross foreign assets and total foreign liabilities, including debt owed to the IMF. All foreign assets and foreign liabilities are converted to SDRs at the program exchange rates, as described in paragraph 4. For reference, at end-December 2014, NFA was MGA 1,389 billion, calculated as follows:

Foreign Assets	2,013.221
Of which:	
Cash	0.048
Demand deposits	233.536
Term deposits and securities	1,489.464
Other foreign assets	290.173
Foreign Liabilities	624.150
Of which:	
Non-residents deposits	2.439
Deposits of international organizations	0.505
Use of Fund credit and loans	252.190
Medium-and long-term foreign liabilities (including SDR allocation)	369.016
Net Foreign Assets	1,389.071

Adjustment

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

B. Ceiling on Net Domestic Assets of the Central Bank of Madagascar

8. The NDA of CBM are defined as the difference between reserve money and the NFA of the CBM valued in MGA using the program exchange rates as described in paragraph 4. It includes net credit to the government, credit to enterprises and individuals, claims on banks, liabilities to banks (including the proceeds of CBM deposit auctions—*appels d'offres négatifs,* and open market operations), and other items (net). For reference, at end-December 2014, NDA was MGA 1,410 billion, calculated as follows:

Net Foreign Assets	1,389.071
Base Money	2,798.794
Of which:	
Currency in circulation	1,825.522
Currency in banks	169.994
Bankers' reserves	801.531
Other deposits included in monetary base	1.747
Net Domestic Assets	1,409.723
Of which:	
Net credit to the central government	651.844
Credit to the economy	8.280
Net credit to depository corporations	-24.000
Other items (net)	773.599

Adjustment

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

III. Fiscal Aggregates

A. Ceiling on the Net Bank Credit to the Government

10. The NBC to the government is measured by the change in net credit to government in the monetary survey; and consists of CBM and commercial bank claims on the central government, including auctioned treasury bills (BTAs) and other securities and liabilities, net of central

government deposits with the CBM and commercial banks, including foreign currency deposits. For reference, at end-December 2014, NBC to the Government was MGA 977.7 billion, of which MGA 651.8 billion from the central bank and MGA 325.9 billion from commercial banks.

Adjustment

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

12. The ceiling on the NBC to the government will be adjusted *downward* by any shortfall in financial compensation paid to the CBM for losses made during 2011-13 (see Table I.1).

B. Floor on Tax Revenue

13. **Government tax revenue** is measured on a gross basis that is, before the refund of VAT credits. It comprises all domestic taxes and taxes on foreign trade received by the central government treasury. Tax revenue excludes: (1) the receipts from the local sale of in-kind grants, (2) any gross inflows to the government on account of signature bonus receipts from the auction of hydrocarbon and mining exploration rights, and (3) tax arrears recorded in the context of regularization operations, such as those related to the recapitalization of Air Madagascar in 2016. Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and the Directorate of Treasury in the Ministry of Finance and Budget. For reference, for the year ending December 2014, government tax revenue was MGA 2,582.8 billion.

C. Floor on Priority Social Spending

14. **Priority social spending** includes spending primarily related to interventions in nutrition, education, health, and the provision of social safety nets

15. Priority social spending is calculated as the sum of spending defined above related to (i) the Presidency; (ii) the Prime Minister's Office; (iii) the Ministry of Finance and Budget; (iv) the Ministry of Health; (v) the Ministry of Population and Social Affairs; and (vi) the Ministry of National Education. (See table 2).

D. Domestic Expenditure Arrears

16. **Expenditure arrears** consist of payment obligations related to acquisition of goods and services by the central government liquidated and not paid after 90 days. Arrears on VAT refund consists of eligible claims not paid after 60 days of presentation by the taxpayer.

IV. External Debt

A. Ceiling on External Payment Arrears

17. These arrears consist of overdue debt-service obligations (i.e., payments of principal and interest) related to loans contracted or guaranteed by the government or CBM. Debt service obligations (including unpaid penalties and interest charges) are overdue if they have not been paid by the due date or within a grace period agreed with, or unilaterally granted by, each creditor before the due date. They exclude arrears resulting from nonpayment of debt service for which rescheduling negotiations are under way or that are in dispute. This monitoring target should be observed on a continuous basis.

B. Ceilings on Non-Concessional External Debt

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

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

20. For loans carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the loan would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the loan contract. The program reference rate for the six-month USD LIBOR is 3.85 percent and will remain fixed for the duration of the program. The spread of six-month Euro LIBOR over six-month USD LIBOR is -296 basis points. The spread of six-month JPY LIBOR over six-month USD LIBOR is -336 basis points. The spread of six-month GBP LIBOR over six-month USD LIBOR is -145 basis points. For interest rates on currencies other than Euro, JPY, and GDP, the spread over six-month USD LIBOR is 0 basis points.[16] Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.

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

Medium- and Long-Term External Debt

21. A continuous ceiling applies to new nonconcessional external debt with nonresidents with original maturities of more than one year contracted or guaranteed by the government or CBM. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. It applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the government or CBM.

22. Excluded from the ceiling are (i) the use of IMF resources; (ii) concessional debts; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; and (iv) debts classified as international reserve liabilities of CBM. If the government has a special need for external nonconcessional financing, discussions with IMF staff should take place in advance to consider including the request in the program.

Short-Term External Debt

23. A continuous ceiling applies to new nonconcessional external debt with nonresidents with original maturities of up to and including one year contracted or guaranteed by the government or CBM. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. It applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the government or CBM.

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

V. Zero-Ceiling on CBM Buyback Operations at Non-Market Rates in the Interbank foreign Exchange Market

25. With the aim of maintaining a flexible exchange rate and improving the functioning of the interbank foreign exchange market, the CBM ceased buyback operations at non-market rates in the interbank foreign exchange market on September 4, 2015. The zero-ceiling on CBM buyback operations at non-market rates is applicable since the point in time when the CBM declared that it had ceased to engage in such operations in the foreign exchange market (September 4, 2015). For transparency and monitoring reasons, CBM will increase the reporting of exchange rate data as described in Table 1.

VI. Data Reporting

26. The data listed in Table 1 will be provided for monitoring performance under the program based on data templates agreed with IMF staff. The best available data will be submitted, so that any subsequent data revisions will not lead to a breach of indicative targets. All revisions to data will be promptly reported to IMF staff. For variables that are relevant for assessing performance against program objectives, but not specifically defined in this memorandum, the authorities will consult with IMF staff as needed on the appropriate way of measuring and reporting.

Table 1. Madagascar: Data Reporting Requirements

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

Table 1. Madagascar: Data Reporting Requirements (concluded)	
Item	**Periodicity**
Treasury operations (OGT)	Monthly, within eight weeks of the end of each month
Stock of domestic arrears, including arrears on expenditure and VAT refunds	Monthly, within eight weeks of the end of each month
Priority social spending as defined by the indicative target	Monthly, within eight weeks of the end of each month
Subsidies to JIRAMA's suppliers	Monthly, within eight weeks of the end of each month
State-owned enterprise data	
Data summarizing the financial position of JIRAMA and Air Madagascar	Quarterly, by the end of the subsequent quarter
Debt data	
Ministry of Finance and Budget (MFB)	
Public and publically-guaranteed debt stock at end of month, including: (i) by creditor (official, commercial domestic, commercial external); (ii) by instrument (Treasury bills, other domestic loans, external official loans, external commercial loans, guarantees); and (iii) in case of new guarantees, the name of the guaranteed individual/institution.	Monthly, within four weeks of the end of each month
External data	
Central Bank of Madagascar (CBM)	
Balance of payments	Quarterly, by the end of the subsequent quarter
Real sector and price data	
INSTAT	
Consumer price index data (provided by INSTAT)	Monthly, within four weeks of the end of each month
Details on tourism	Monthly, within twelve weeks of the end of each month
Electricity and water production and consumption	Monthly, within twelve weeks of the end of each month
Other data	
OCH	
Petroleum shipments and consumption	Monthly, within four weeks of the end of each month

Table 2. Social Spending in 2015 and First Quarter of 2016 by Ministry
(Billions of Ariary)

	End- Dec 2015	End-March 2016
01 Présidence (Presidency)	**4**	**1**
031 Coordination de la lutte contre le SIDA		
05 Primature (Prime Minister's Office)	**36**	**3**
095 Projet d'urgence de securité alimentaire et de reconstruction		
104 Projet d'urgence pour la sécurité alimentaire et protection sociale (PURSAPS)		
105 Filets sociaux de securité		
21 Ministère des Finances et du Budget (Ministry of Finance and Budget)	**43**	**4**
189 Appui d'urgence aux services essentiels d'éducation, de santé et de nutrition		
193 Appui aux couches défavorisées		
194 HIMO - développement		
52 Ministère de l'Eau, de l'Assainissement et de l'Hygiène (Ministry of Water, Sanitation and Hygiene)	**16**	**2**
056 Approvisionnement en eau potable et assainissement		
065 Programme d'approvisionnement en eau potable et assainissement en milieu rural (PAEAR)		
082 Alimentation en eau dans le sud		
084 Evacuation des eaux usées et des ordures ville Antananarivo (SAMYA)		
71 Ministère de la Santé (Ministry of Health)	**43**	**9**
026 Appui aux districts sanitaires		
030 Réhabilitation, construction, équipement des infrastructures		
024 Appui au système hospitalier de référence		
025 Appui aux programmes de lutte contre les maladies transmissibles		
028 Equipes sanitaires mobiles		
045 Appui aux programmes de lutte contre les maladies non transmissibles		
046 Appui aux programmes de lutte contre les maladies epidémo-endémiques		
022 Appui à la politique de survie de la mère et de l'enfant (ex-bien être de la famille)		
Aide d'urgence pour la lutte contre la peste		
76 Ministère de la Population, de la Protection Sociale et de la Promotion de la Femme (Ministry of Population, Social Protection and Promotion of Women)	**1**	**0**
056 Appui aux services sociaux de base		
050 Promotion de développement socio-économique des femmes		
035 Promotion de l'intégration socio-économique des personnes handicapées		
040 Appui aux ménages en difficulté		
046 Amélioration de la condition de vie des personnes âgées		
031 Droits et protection des enfants (ex-services urbains de base)		
81 Ministère de l'Education Nationale (Ministry of National Education)	**62**	**14**
104 Appui à l'enseignement primaire en matière de nutrition		
105 Redynamisation de l'enseignement primaire		
107 Education pour tous (volet MINESEB)		
112 Travaux et équipement pour les écoles primaires		
136 Projet d'appui d'urgence a l'éducation pour tous (PAUEPT)		
138 Programme d'appui aux services sociaux de base-éducation (PASSOBA)		
113 Travaux et équipement des collèges		
102 Appui à l'enseignement general		
132 Travaux et équipement des lycées		
TOTAL	**204**	**33**

Source: Malagasy authorities.

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

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

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

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

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

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

(b) Under the definition of debt set out in point 8(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

November 4, 2015

STAFF-MONITORED PROGRAM AND REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY—INFORMATIONAL ANNEX

Prepared By | The African Department

CONTENTS

FUND RELATIONS

(As of September 30, 2015)

Membership Status: Joined: September 25, 1963; Article VIII

General Resources Account:	**SDR Million**	**%Quota**
Quota	122.20	100.00
Fund Holdings of currency	122.13	99.94
Reserve Tranche Position	0.07	0.06

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	117.09	100.00
Holdings	59.05	50.43

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
RCF Loans	30.55	25.00
ECF Arrangements	24.75	20.25

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF[1]	Jul 21, 2006	Jul 20, 2009	73.32	53.03
ECF	Mar 01, 2001	Mar 01, 2005	91.65	91.65
ECF	Nov 27, 1996	Nov 30, 2000	81.36	78.68

[1] Formerly PRGF.

Projected Payments to Fund[2]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2015	2016	2017	2018	2019
Principal		10.61	8.25	5.89	3.06
Charges/Interest	0.01	0.03	0.03	0.03	0.03
Total	0.01	10.64	8.28	5.92	3.09

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

Implementation of HIPC Initiative:

	Enhanced
I. Commitment of HIPC assistance	Enhanced Framework
Decision point date	Dec 2000
Assistance committed	
by all creditors (US$ Million)[1]	835.75
Of which: IMF assistance (US$ million)	19.17
(SDR equivalent in millions)	14.73
Completion point date	Oct 2004
II. Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	14.73
Interim assistance	5.62
Completion point balance	9.11
Additional disbursement of interest income[2]	1.69
Total disbursements	16.42

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

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

Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI – eligible debt (SDR Million)[1]	137.29
Financed by: MDRI Trust	128.50
Remaining HIPC resources	8.79

II. Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
January 2006	N/A	137.29	137.29

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

Safeguards Assessments:

A safeguards assessment for Banque Centrale de Madagascar (BCM) was completed in January 2015. Previous assessments were completed in March 2006 and September 2008. The update assessment found that the political crisis in Madagascar during 2009-14 has affected the governance and financial autonomy of the BCM. Capacity building and the development of internal controls have also been interrupted and little progress had been made in implementing the safeguards measures recommended by the 2006 and 2008 assessments. The 2015 assessment updated the recommendations in all areas of the safeguards framework. The report noted that: (i) governance arrangements did not provide for adequate oversight and recommended the establishment of an audit committee; (ii) the BCM had significant outstanding claims on the government and was in a negative equity position, thus its financial autonomy had been compromised; and (iii) some key functions, including internal audit, should be modernized and the BCM legal framework updated to better safeguard its autonomy and strengthen governance. The BCM has since taken steps to address some of the assessment's priority recommendations, including publishing its financial statements, and through technical assistance on its legal framework, improving its legal framework and internal audit functions, and beginning the implementation International Financial Reporting Standards (IFRS).

Exchange Rate Arrangement:

The currency of the Republic of Madagascar is the Malagasy ariary. The de jure exchange rate arrangement is free floating. The exchange rate is determined in the official interbank market. The Central Bank of Madagascar (CBM) intervenes in the interbank market to smooth large exchange rate fluctuations and meet foreign reserve targets. Information on CBM daily interventions is not publicly available. The minimum, maximum, and weighted average daily rates as well as the number and amount of transactions are made available to the public through the CBM official site. The de facto exchange rate arrangement is classified as floating.

The Republic of Madagascar accepted the obligations of Article VIII of the IMF Articles of Agreement with effect from September 18, 1996. The Republic of Madagascar maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation:

The most recent Article IV consultation was concluded on January 16, 2015 (Country Report No. 15/24).

Technical Assistance:

Technical assistance provided to Madagascar following the normalization of relations in March, 2014 are listed below.

Fiscal Affairs Department (FAD)

	Year of delivery
Diagnostic Mission: Improving Tax and Customs Revenue Collection	2014
PFM Reform Strategy	2014
Medium-Term Fiscal Framework (MTFF)	2014
Energy Subsidy Reform	2014
Tax Policy Review	2014
MTFF and Natural Resources Management	2014
Tax Administration: Review of the legal framework for taxation of mining and petroleum operations	2015
Revenue Mobilization: Transfer pricing	2015
Budget Formulation: Strengthening medium-term macro fiscal and budget frameworks	2015
Customs Administration: Risk management and post clearance audit	2015
Revenue Administration: Action plan to improve tax and customs revenue collection	2015
Public expenditure management: Control and audit on public expenditure	2015
Management of Expenditure Arrears	2015

Monetary and Capital Markets Department (MCM)

Technical Assistance Needs Assessment	2014
Introduction of IFRS in Central Bank Accounting	2015
Strengthening Internal Audit and Controls	2015
Strengthening Monetary Policy Implementation	2015

Legal Department (LEG) and Monetary and Capital Markets Department (MCM)

Central Banking Law	2014

Statistics Department (STA)

National Accounts	2015
Price Statistics	2015
Balance of Payments Statistics	2015

Resident Representative:

Mr. Patrick Imam has been the Resident Representative since September 2014.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

November 4, 2015

STAFF-MONITORED PROGRAM AND REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS[1]

Approved By
David Owen and Chris Lane (IMF) and John Panzer, Director, Macro Fiscal Management Global Practice (World Bank)

Prepared by the Staffs of the International Monetary Fund and the International Development Association

Risk of external debt distress:	Moderate
Augmented by significant risks stemming from domestic public and/or private external debt?	No

Madagascar's risk of external debt distress is assessed to be 'moderate'. This represents an increase in the risk rating relative to the last DSA carried out in 2014. The deterioration in debt dynamics is mainly attributed to a significant nominal exchange rate depreciation in 2015. The public DSA suggests that Madagascar's total public and publically guaranteed (PPG) debt dynamics are sustainable, although weak fiscal revenue generation is a source of vulnerability.

[1] Prepared by IMF and World Bank staff, in consultation with the country authorities, during the September 2015 staff mission to negotiate an RCF. This DSA follows the IMF and World Bank Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries, November 5, 2013 (available at http://www.imf.org/external/pp/longres.aspx?id=4827).

INTRODUCTION

1. **This joint DSA has been prepared by IMF and World Bank staff**. It is based on the framework for LICs approved by the respective Executive Boards. The framework takes into account indicative thresholds for debt burden indicators determined by the quality of the country's policies and institutions.[2] The assessment comprises a baseline scenario and a set of alternative scenarios.

2. **This DSA includes public debt and guarantees of the *general* government.** The DSA does not include the debt of local government or state owned enterprises (other than through direct guarantees). The measure of debt is on a *gross* rather than *net* basis. And the *residency* criterion is used to determine the split between external and domestic debt.

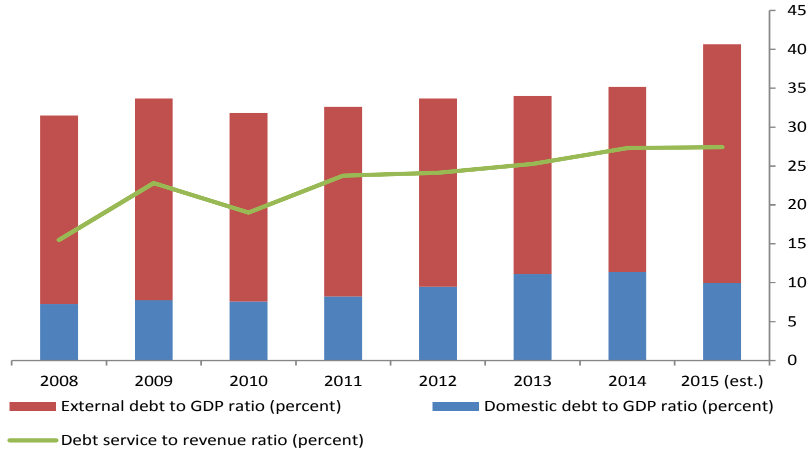
RECENT DEVELOPMENTS AND CURRENT DEBT SITUATION

3. **Over 2008-14, domestic debt was the main driver of total PPG debt in Madagascar** (Figure 1). A significant reduction in loans from development partners during the 2008-13 crisis period resulted in a greater reliance on domestic sources to finance budget deficits. In 2008, domestic debt was 7.3 percent of GDP, but increased to 11.4 percent by end-2014. This debt includes domestic budgetary arrears, which increased sharply in 2013. In contrast, external PPG debt was maintained at around 24 percent of GDP over 2008-14. The authorities also refrained from borrowing externally on non-concessional terms, which helped to maintain debt sustainability. Overall, total public debt rose from around US $2.5 billion (33 percent of GDP) in 2007 to US$3.5 billion (35 percent of GDP) in 2014. This modest increase in debt remains substantially below the pre-HIPC peak of 95 percent of GDP. The debt service to revenue ratio, however, has increased due to a greater reliance on domestic financing and declining fiscal revenues.

4. **A significant nominal exchange rate depreciation in 2015 increased the burden of external debt**. In 2015, a projected depreciation of 8 percent in the period average nominal effective exchange rate (22 percent depreciation against the dollar) is expected to increase external debt by 6 percentage points of GDP. And exchange rate base effects will lead to a further deterioration in the debt-to-GDP ratio in 2016. Nominal debt increased by a relatively modest

[2] According to the World Bank Country and Policy Institutional Assessment (CPIA) Index, Madagascar is rated as a 'low' performer, unchanged from the last DSA. The indicative thresholds for external debt applicable for that category of countries are: (i) 30 percent for the PV of debt-to-GDP ratio; (ii) 100 percent for PV of debt-to-exports ratio; (iii) 200 percent for the PV of debt to fiscal revenues ratio; (iv) 15 percent for the debt service to exports ratio; and (v) 18 percent for the debt service to revenue ratio. The indicative threshold for the PV of total PPG debt is 38 percent of GDP.

Figure 1: Debt Level and Service Ratios



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

3 percentage points of GDP, and this was largely offset by real GDP growth. The larger than expected exchange rate depreciation, therefore, is the primary driver of the deterioration in debt dynamics in 2015, relative to the forecast in the 2014 DSA.

5. **The majority of external debt is owed to multilateral creditors on highly concessional terms**. Table 1 summarizes PPG debt by creditor type. Around one-third of total debt is held by domestic creditors mainly in the form of bonds and loans to the private sector. Debt to the central bank and arrears were also relatively high at around 2.5 percent of GDP respectively in 2014. The vast majority of external debt is held by multilateral creditors, in particular the World Bank and African Development Bank. This debt is highly concessional.

Table 1: Break-down of Total PPG Debt (end-2014)

Creditor	Amount (US$m)	Percent of GDP	Percent of total
Domestic debt, of which:	**1,217**	**11.4**	**34.1**
Treasury bills	425	4.0	11.9
Debt to the Central Bank	276	2.6	7.7
Arrears	282	2.6	7.9
Other inc. loans	234	2.2	6.5
External debt, of which:	**2,357**	**23.7**	**65.9**
Multilateral	1,854	18.7	51.9
Paris Club	107	1.1	3.0
Non-Paris Club	380	3.8	10.6
Commercial	17	0.2	0.5
Total PPG debt	**3,574**	**35.1**	**100.0**

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

6. **Private external debt is mainly issued by local subsidiaries of multinational companies.** According to the authorities, external debt owed by *domestically* owned companies and households is negligible. There are, however, a number of multinational companies—for instance in the mining, banking, telecommunication sector—which wholly own local subsidies with external debt. The authorities do not have comprehensive data on these obligations. But by far the largest of these debtors is the Nickel/Cobalt mine and processing facility, which has external debt of around US$2bn (21 percent of GDP). This obligation has caused total external debt to increase from 24 percent of GDP in 2007 to 44 percent at end-2014. It is projected that this commercial loan will be fully repaid by around 2030.

UNDERLYING ASSUMPTIONS

7. **The key variables driving debt dynamics are forecast to improve over coming years** (Box 1). The DSA projections are consistent with the authority's plan to scale-up much needed infrastructure and social spending. Much of this investment will be financed through concessional external borrowing and grants, although some non-concessional borrowing is envisaged throughout the forecast horizon. This will increase during the forecast horizon, and as such, the average grant element of new borrowing is projected to decline from 40 percent today to around 30 percent in 2035. The current assumptions are somewhat more conservative than the 2014 DSA.

8. **The main risks to these assumptions relate to revenue generation and donor grant support, although these are symmetrical in nature**. Continued weak revenue performance and a low donor grant support (perhaps as a result of the failure to reform on revenue) pose significant risks to debt sustainability. However, there is also significant upside potential to generate revenues, especially from such a low base. This has the potential to boost the ability to service higher debt levels and stimulate greater donor support. In this sense, risks are both to the upside and downside.

Box 1. Baseline Macroeconomic Assumptions

Real GDP growth. Growth is expected to be lower in the near term than projected in the 2014 DSA, largely as a result of natural disasters and continued political uncertainty, which held back reforms and private investment. Growth is expected to steadily increase over the next 5 years, stabilizing at 5 percent for the medium term. This is driven by improved confidence, further re-engagement of development partners, and increased mining exports.

Current account. The decline in global oil and rice prices led to an improvement in the current account, which was only partially offset by lower than expected mining revenues. In coming years, a bounce back in imports is projected, as domestic consumption and investment recover. Over the medium term, the non-interest current account deficit is expected to stabilize at 3.0-3.5 percent of GDP, similar to the 2014 DSA.

Grants. Donor grant support has been significantly lower in 2014 and 2015 than anticipated in the 2014 DSA. This has led to a downward revision to medium term projections of grant support to around 2.5 percent of GDP per annum. Over the long-run, grants are assumed to decline to 0.6 percent of GDP by 2035.

Revenues. This is an area of vulnerability for debt sustainability. Tax revenues have fallen from (a relatively modest) 12.1 percent of GDP in 2008, to 9.9 in 2014. This is lower than anticipated in the 2014 DSA, and so the path of revenue going forward is projected to rise at a more modest pace.

Expenditure. Expenditure will be somewhat constrained by the lower than expected revenue projection, and so is somewhat below the 2014 DSA. However, the primary deficit is expected to be higher in the near term in order to accommodate a modest scaling up of capital investment and social spending.

Table 2: Madagascar; Baseline Macroeconomic Assumptions

		2015	2016	2017	2018	2019
Real GDP growth (percent)	2015 DSA	3.2	4.3	4.4	4.5	4.7
	2014 DSA	4.0	4.5	4.5	4.5	4.5
Non-interest current account deficit (percent GDP)	2015 DSA	1.5	1.5	1.8	3.1	3.3
	2014 DSA	5.4	5.2	5.0	4.3	3.9
Primary deficit (percent of GDP)	2015 DSA	3.5	1.9	3.6	2.9	2.7
	2014 DSA	1.4	0.7	1.4	1.3	1.3
Total revenues (percent of GDP)	2015 DSA	12.4	13.5	13.8	14.2	14.4
	2014 DSA	15.0	16.0	15.7	15.9	16.3
Grants (percent of GDP)	2015 DSA	2.1	3.0	2.6	2.7	2.4
	2014 DSA	3.7	3.7	3.7	3.7	3.7
Non-Interest Expenditure (percent of GDP)	2015 DSA	15.9	15.4	17.4	17.1	17.1
	2014 DSA	16.4	16.7	17.1	17.2	17.5

Source: IMF staff projections.

EXTERNAL DSA

Baseline scenario

9. **The level of PPG external debt in 2014 is a little over US$2.5 billion, and is projected to grow gradually throughout the forecast horizon**. PPG external debt is forecast to increase from 24 percent of GDP in 2014 to peak at 34 percent of GDP in 2020 (Table 3). This is driven by a step-up in foreign financed investment, consistent with the authority's National Development Plan. As domestic debt markets deepen (see below), PPG external debt will decline as a proportion of GDP to around 30 percent of GDP. A persistent trade deficit and outflows from the mining sector[3] are balanced with increasing grant inflows (over the next decade) and relatively strong growth. FDI inflows are assumed to be lower than that experienced over the last few years, during which major mining projects were being constructed.

10. **Under the baseline projection, all PPG external debt indicators remain below the policy-dependent debt burden thresholds** (Figure 2). The present value (PV) of the 2014 level of external debt, 13 percent of GDP, is projected to increase to 20 percent by 2035. This projection is broadly consistent with the medium term forecast from the last DSA conducted in 2014.

11. **Private external debt is projected to decline slowly, as the mining project loans are repaid.** Given the exceptional nature of this project, the DSA does not forecast substantial new external borrowing from the private sector. Furthermore, this debt is not assessed to pose a significant threat to external sustainability, as the ultimate liability of these loans is to the multinational shareholders, rather than resident entities (such as domestic banks or the government).

Alternative scenarios

12. **The two standard DSA stress test scenarios are applied to the baseline external PPG debt projection.** First, the standard bounds test applies pre-defined shocks to the key macroeconomic variables that drive external debt (summarized in Footnote 1 of Figure 2). Second, a historical scenario where macroeconomic variables are assumed to equal their average over 2004-13 is imposed on the baseline projection. These shocks are detailed in Table 4.

13. **For the standard bounds tests, two scenarios cause a breach of the thresholds for PPG external**. A one-time 30 percent depreciation shock would cause the PV of debt-to-GDP to peak at 32 percent, slightly above the 30 percent threshold implied by Madagascar's CPIA rating. The breach for the PV of debt-to-revenue is larger, peaking at just below 249 percent compared

[3] The large residual in Table 3 is partly related to mining activity. Mining exports are recorded in full in the balance of payment statistics. However, only a fraction of these receipts actually returns to Madagascar, with the remainder being repatriated to the parent companies.

to a threshold of 200 percent. For this metric, the standard shock to exports[4] also causes a breach of the threshold.

14. **The historical scenario[5] projects a rapid increase in all debt metrics and causes a breach for three of the five external debt thresholds.** These scenarios cause a substantial breach in the thresholds, especially for the PV of debt-to-GDP and the PV of debt-to-revenue. But there is reason to place less weight on this scenario—the very large current account deficit in 2008 and 2009 (over 20% of GDP in both years) was mainly driven by substantial imports associated with large mining investments, which were partly financed through non-debt creating FDI. These did not lead to a build-up of PPG external debt, and this period is not representative of the normal economic environment in Madagascar.

PUBLIC DSA

Baseline scenario

15. **Domestic PPG debt as a proportion of GDP is projected decline over the next decade**, with authorities substituting away from local financing into concessional borrowing, as donor relations normalize. Domestic PPG debt is then expected to grow as a proportion of GDP thereafter, as domestic markets deepen.

16. **The *present value* of total PPG debt is projected to remain around 25-30 percent of GDP throughout the forecast - below the threshold** (Figure 3 and Table 5)**.** Madagascar's relatively weak revenue to GDP ratio leaves the authorities somewhat vulnerable on the debt service to revenue measure. This risk is likely to increase through time as higher interest payments (associated with less concessional financing) increases at a faster rate to revenue mobilization.

Alternative scenarios

17. **All three of the alternative scenarios used to stress-test the baseline breach the risk threshold** (Figure 3). The scenario whereby the primary deficit as a proportion of GDP remains unchanged throughout the forecast generates the highest debt to GDP ratio trajectory. However, staff and authorities agree that reducing the current gap between revenue and spending is a priority.

CONCLUSION

18. **The authorities agree with the analysis presented in this DSA.** The DSA was discussed with authorities during the September mission, and there was broad agreement on the risks to debt sustainability. The authorities have begun using the LIC DSA template to help develop their

[4] Export value growth at historical average minus one standard deviation

[5] Key macroeconomic variables (non-interest current account, growth, GDP deflator, growth of exports, current official transfers and net FDI) remain fixed at the average of the 2004-13 period.

medium-term debt strategy and assess risks. Reforms to enhance debt resilience should focus on i) increasing tax revenues to increase the capacity of the state to service debt; ii) ensure that debt continues to be financed on the most concessional terms possible; iii) ensure that investments are carefully prioritized to enhance growth and human capital accumulation; and iv) improve debt monitoring capacity, especially in terms of controlling debt guarantees and potential contingent liabilities.

Table 3. Madagascar: External Debt Sustainability Framework, Baseline Scenario, 2012-35[1]

(In percent of GDP; unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**44.9**	**43.9**	**44.3**	**38.0**	**14.5**	**51.3**	**52.0**	**49.6**	**47.7**	**45.9**	**44.8**	**48.6**	**37.5**	**35.3**	**36.2**
of which: public and publicly guaranteed (PPG)	24.2	22.8	23.7	24.2	16.3	31.2	32.6	32.7	33.0	33.3	33.8	32.8	32.9	28.4	31.3
Change in external debt	2.6	-1.0	0.5	2.1	16.2	7.0	0.7	-2.5	-1.9	-1.7	-1.2	0.1	-1.6	0.6	-0.6
Identified net debt-creating flows	-1.2	-2.5	-3.0			-2.8	-3.8	-3.6	-2.5	-2.4	-2.7		-2.7	-3.2	
Non-interest current account deficit	**6.5**	**5.3**	**-0.1**	**8.9**	**7.0**	**1.5**	**1.5**	**1.8**	**3.0**	**3.2**	**3.2**	**2.4**	**3.5**	**2.6**	**3.1**
Deficit in balance of goods and services	9.5	8.4	4.3	13.8	6.3	3.3	3.3	3.7	5.0	5.5	5.4	4.4	5.8	5.1	5.5
Exports	29.2	30.3	32.8			34.3	37.4	37.8	37.1	37.1	37.5		38.1	43.3	39.7
Imports	38.7	38.7	37.1			37.6	40.7	41.5	42.2	42.6	42.9		43.9	48.5	45.2
Net current transfers (negative = inflow)	-6.0	-6.0	-6.9	-6.4	2.6	-5.1	-5.5	-5.5	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4
of which: official	-1.2	-1.3	-2.0	-2.1	1.7	-2.0	-2.1	-2.4	-2.2	-2.0	-1.9	-2.1	-1.4	-0.8	-1.2
Other current account flows (negative = net inflow)	3.0	2.9	2.5	1.5	1.0	3.3	3.7	3.6	3.4	3.1	3.2	3.4	3.1	2.8	3.0
Net FDI (negative = inflow)	**-7.8**	**-5.2**	**-2.9**	**-5.3**	**2.3**	**-3.1**	**-3.3**	**-3.5**	**-3.7**	**-3.9**	**-4.1**	**-3.6**	**-4.1**	**-4.1**	**-4.1**
Endogenous debt dynamics 2/	**0.2**	**-2.6**	**0.0**	**-3.2**	**4.1**	**-1.2**	**-2.0**	**-1.9**	**-1.8**	**-1.7**	**-1.7**	**-1.7**	**-2.1**	**-1.6**	**-1.9**
Contribution from nominal interest rate	0.3	0.3	0.3	0.3	0.1	0.4	0.3	0.3	0.3	0.4	0.4	0.3	0.4	0.6	0.5
Contribution from real GDP growth	-1.3	-1.0	-1.4	-1.3	1.5	-1.6	-2.3	-2.1	-2.1	-2.1	-2.2	-2.1	-1.8	-1.6	-1.7
Contribution from price and exchange rate changes	1.2	-1.9	1.2			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**3.8**	**1.4**	**3.4**	**-4.2**	**14.1**	**9.8**	**4.5**	**1.1**	**0.5**	**0.6**	**1.5**	**3.0**	**1.1**	**3.9**	**2.2**
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	33.8			37.7	38.2	36.0	34.4	32.9	31.9		26.5	27.1	
In percent of exports	...	...	103.2			109.8	102.2	95.3	92.6	88.7	85.0		69.5	62.4	
PV of PPG external debt	**...**	**...**	**13.2**			**17.5**	**18.7**	**19.1**	**19.7**	**20.3**	**20.9**		**21.9**	**20.2**	
In percent of exports	**...**	**...**	**40.3**			**51.1**	**50.1**	**50.6**	**53.1**	**54.6**	**55.8**		**57.5**	**46.6**	
In percent of government revenues	**...**	**...**	**130**			**169**	**172**	**169**	**168**	**166**	**164**		**157**	**127**	
Debt service-to-exports ratio (in percent)	**2.0**	**1.7**	**2.9**			**2.7**	**3.0**	**2.9**	**2.7**	**2.7**	**2.7**		**3.3**	**3.9**	
PPG debt service-to-exports ratio (in percent)	**2.0**	**1.7**	**2.9**			**2.7**	**3.0**	**2.9**	**2.7**	**2.7**	**2.7**		**3.3**	**3.9**	
PPG debt service-to-revenue ratio (in percent)	**6.2**	**5.5**	**9.5**			**9.0**	**10.1**	**9.8**	**8.6**	**8.2**	**7.9**		**9.0**	**10.2**	
Total gross financing need (Millions of U.S. dollars)	-77.4	71.0	-221.2			-64.7	-63.8	-58.1	35.8	34.9	4.9		108.6	29.1	
Non-interest current account deficit that stabilizes debt ratio	3.8	6.4	-0.6			-5.5	0.8	4.2	4.9	5.0	4.4		5.1	1.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	3.0	2.3	3.3	2.9	3.5	3.2	4.3	4.4	4.5	4.7	5.0	4.3	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	-2.7	4.5	-2.6	6.7	9.9	-11.9	-8.8	2.1	2.2	2.4	1.7	-2.1	1.8	1.9	1.9
Effective interest rate (percent) 5/	0.7	0.6	0.8	0.8	0.3	0.7	0.6	0.6	0.7	0.9	1.0	0.7	1.2	1.9	1.6
Growth of exports of G&S (US dollar terms, in percent)	9.4	11.0	8.9	10.6	16.3	-4.8	3.6	7.7	5.0	7.1	8.0	4.4	7.7	8.6	8.0
Growth of imports of G&S (US dollar terms, in percent)	2.1	6.9	-3.6	8.4	21.5	-7.8	2.8	8.7	8.5	8.2	7.7	4.7	7.6	8.5	7.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	42.8	37.4	40.4	37.3	36.7	36.5	38.5	34.0	28.2	31.5
Government revenues (excluding grants, in percent of GDP)	9.6	9.6	10.1	10.7	1.0	10.3	10.9	11.3	11.8	12.2	12.8	11.6	14.0	14.7	14.5
Aid flows (in Millions of US dollars) 7/	120	134	246			404	441	401	438	426	417		382	279	
of which: Grants	120	134	246			200	239	253	264	248	249		245	206	
of which: Concessional loans	0.0	0.0	0.0			204.0	202.1	148.5	173.5	178.2	167.6		136.6	72.8	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.5	4.1	3.8	3.7	3.4	3.1	3.6	2.3	1.3	2.0
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			64.2	61.9	67.2	65.2	62.8	63.1	64.1	59.4	42.6	52.6
Memorandum items:															
Nominal GDP (Millions of US dollars)	9920	10602	10674			9700	9223	9824	10494	11249	12011		16781	32896	
Nominal dollar GDP growth	0.3	6.9	0.7			-9.1	-4.9	6.5	6.8	7.2	6.8	2.2	6.9	7.0	6.9
PV of PPG external debt (in Millions of US dollars)			1311.6			1480.3	1685.5	1845.3	2038.0	2251.1	2462.9		3616.8	6538.7	
(PVt-PVt-1)/GDPt-1 (in percent)						1.6	2.1	1.7	2.0	2.0	1.9	1.9	1.4	1.1	1.4
Gross workers' remittances (Millions of US dollars)	...	...	...			...	...	...	...	...	...		...	...	
PV of PPG external debt (in percent of GDP + remittances)	...	...	13.2			17.5	18.7	19.1	19.7	20.3	20.9		21.9	20.2	
PV of PPG external debt (in percent of exports + remittances)	...	...	40.3			51.1	50.1	50.6	53.1	54.6	55.8		57.5	46.6	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.9			2.7	3.0	2.9	2.7	2.7	2.7		3.3	3.9	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

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

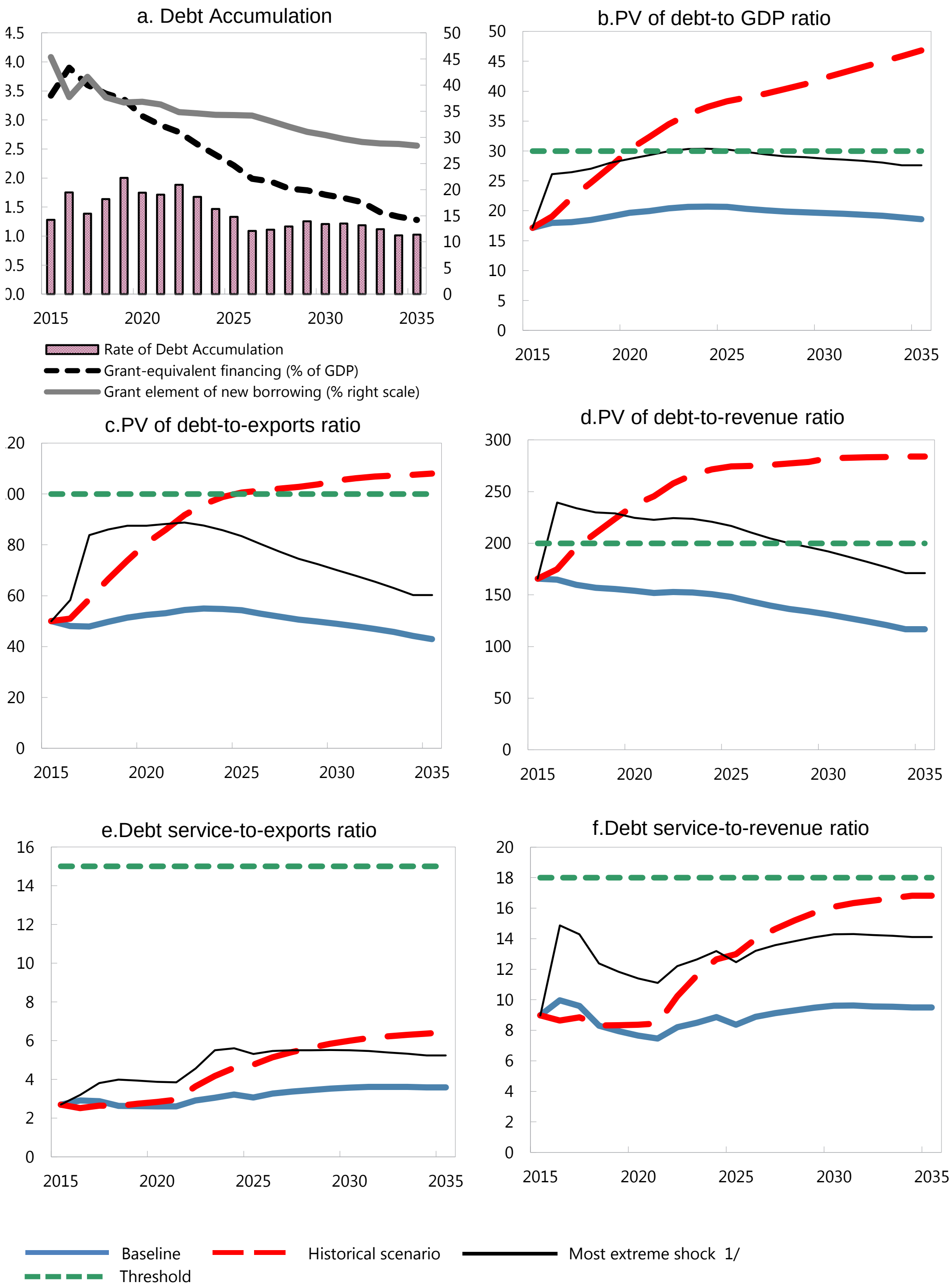
5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

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

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Figure 2. Madagascar: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015-35 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Table 4. Madagascar: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015-35

(In percent)

	Projections																				
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	**2025**	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
											PV of debt-to GDP ratio										
Baseline	17	18	18	18	19	20	20	20	21	21	**21**	20	20	20	20	20	20	19	19	19	19
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2015-2035 1/	17	19	22	25	27	30	32	34	36	37	**38**	39	40	40	41	42	43	44	45	46	47
A2. New public sector loans on less favorable terms in 2015-2035 2	17	18	19	20	22	23	24	25	25	26	**26**	26	26	26	27	27	27	27	28	28	28
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	17	18	20	20	21	21	22	22	23	23	**23**	22	22	22	22	21	21	21	21	21	20
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	17	20	25	25	26	26	26	27	26	26	**25**	25	24	23	23	22	22	22	21	20	20
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	17	17	18	18	19	19	20	20	20	20	**20**	20	20	19	19	19	19	19	19	18	18
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	17	19	21	21	21	22	22	23	23	22	**22**	22	21	21	21	20	20	20	20	19	19
B5. Combination of B1-B4 using one-half standard deviation shocks	17	16	18	18	19	19	19	20	20	20	**20**	20	19	19	19	19	19	18	18	18	18
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	17	26	26	27	28	29	29	30	30	30	**30**	30	29	29	29	29	29	28	28	28	27
											PV of debt-to-exports ratio										
Baseline	50	48	48	50	51	52	53	54	55	55	**54**	53	52	51	50	49	48	47	46	44	43
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2015-2035 1/	50	51	59	67	74	81	86	92	96	99	**101**	101	102	103	104	105	106	107	107	107	108
A2. New public sector loans on less favorable terms in 2015-2035 2	50	49	51	55	58	60	63	66	68	69	**69**	68	68	67	67	67	67	66	66	65	64
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	50	47	47	49	51	51	52	54	54	54	**53**	52	51	50	49	48	47	46	45	43	42
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	50	58	84	86	88	87	88	89	88	86	**83**	80	77	75	72	70	68	65	63	60	58
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	50	47	47	49	51	51	52	54	54	54	**53**	52	51	50	49	48	47	46	45	43	42
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	50	51	55	56	58	58	59	60	60	59	**58**	57	55	53	52	51	50	48	47	45	44
B5. Combination of B1-B4 using one-half standard deviation shocks	50	46	52	54	55	56	57	58	59	59	**58**	56	55	54	53	52	51	50	48	47	45
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	50	47	47	49	51	51	52	54	54	54	**53**	52	51	50	49	48	47	46	45	43	42
											PV of debt-to-revenue ratio										
Baseline	166	165	160	157	156	154	152	153	152	151	**148**	144	140	136	134	131	128	124	121	117	117
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2015-2035 1/	166	175	196	210	224	237	246	258	266	271	**274**	275	276	277	279	282	283	283	284	284	319
A2. New public sector loans on less favorable terms in 2015-2035 2	166	168	171	173	177	178	180	185	187	188	**188**	185	183	182	181	180	178	176	174	171	188
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	166	169	174	172	171	168	166	167	167	165	**162**	157	153	149	146	143	140	136	132	128	139
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	166	182	223	216	212	205	201	199	194	188	**181**	174	167	160	155	150	144	138	133	127	137
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	166	151	156	153	153	150	148	149	149	147	**144**	140	136	133	131	128	125	121	118	114	124
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	166	173	182	178	176	171	169	169	167	163	**159**	153	148	144	140	137	132	128	124	119	129
B5. Combination of B1-B4 using one-half standard deviation shocks	166	144	156	153	152	149	147	148	148	145	**143**	138	134	131	128	125	122	119	115	111	121
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	166	239	234	230	229	225	223	224	224	221	**217**	211	205	200	196	192	187	182	177	171	186

Table 4. Madagascar: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015-35 (concluded)

(In percent)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	**2025**	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
						Projections															
											Debt service-to-exports ratio										
Baseline	3	3	3	3	3	3	3	3	3	3	**3**	3	3	3	4	4	4	4	4	4	4
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2015-2035 1/	3	3	3	3	3	3	3	4	4	5	**5**	5	5	6	6	6	6	6	6	6	6
A2. New public sector loans on less favorable terms in 2015-2035 2	3	3	3	3	3	3	3	4	4	4	**4**	4	5	5	5	5	5	5	5	5	5
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	3	3	3	3	3	3	3	3	3	3	**3**	3	3	3	4	4	4	4	4	4	4
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	3	3	4	4	4	4	4	5	6	6	**5**	5	6	6	6	6	5	5	5	5	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	3	3	3	3	3	3	3	3	3	3	**3**	3	3	3	4	4	4	4	4	4	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	3	3	3	3	3	3	3	3	4	4	**4**	4	4	4	4	4	4	4	4	4	4
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	3	3	3	3	3	3	3	4	**3**	4	4	4	4	4	4	4	4	4	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	3	3	3	3	3	3	3	3	3	3	**3**	3	3	3	4	4	4	4	4	4	4
											Debt service-to-revenue ratio										
Baseline	9	10	10	8	8	8	7	8	8	9	**8**	9	9	9	9	10	10	10	10	9	9
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2015-2035 1/	9	9	9	8	8	8	8	10	12	13	**13**	14	15	15	16	16	16	16	17	17	19
A2. New public sector loans on less favorable terms in 2015-2035 2	9	10	9	8	8	8	9	10	10	11	**11**	12	12	13	13	13	13	13	14	14	16
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	9	11	11	9	9	9	8	9	9	10	**9**	10	10	10	11	11	11	11	11	11	12
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	9	10	10	10	10	9	9	10	12	12	**12**	12	12	12	12	12	12	11	11	11	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	9	9	10	8	8	8	7	8	8	9	**8**	9	9	9	9	10	10	9	9	9	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	9	10	10	9	9	8	8	9	10	10	**10**	10	10	10	10	10	10	10	10	10	11
B5. Combination of B1-B4 using one-half standard deviation shocks	9	9	9	8	8	7	7	8	8	9	**8**	9	9	9	9	9	9	9	9	9	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	9	15	14	12	12	11	11	12	13	13	**12**	13	14	14	14	14	14	14	14	14	16
Memorandum item:																					
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	31	31	31	31	31	31	31	31	31	31	**31**	31	31	31	31	31	31	31	31	31	31

Sources: Country authorities; and staff estimates and projections.

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

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

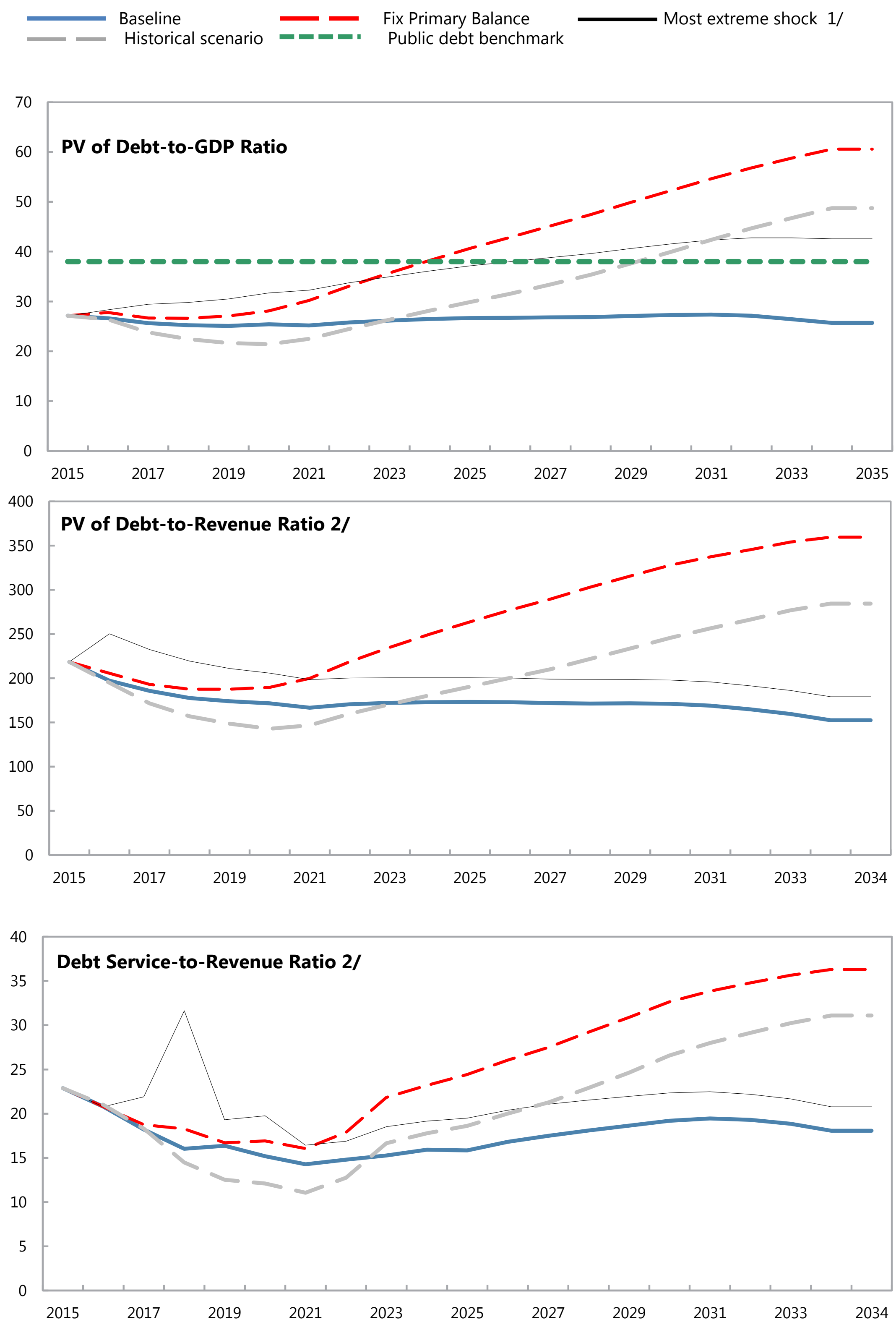
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 3.Madagascar: Indicators of Public Debt Under Alternative Scenarios, 2015-35



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.

2/ Revenues are defined inclusive of grants.

Table 5. Madagascar: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012-35

(In percent of GDP, unless otherwise indicated)

	Actual					Projections									
	2012	2013	2014	Average 5/	Standard Deviation 5/	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	33.7	34.0	35.2	38.9	16.8	40.6	40.1	38.8	38.0	37.6	37.8	38.8	37.3	32.6	36.1
of which: foreign-currency denominated	24.2	22.8	23.7	29.7	16.3	30.7	31.5	31.2	31.2	31.6	32.0	31.4	31.3	26.4	29.5
Change in public sector debt	1.1	0.3	1.2			5.5	-0.5	-1.4	-0.8	-0.3	0.1		-0.3	-1.1	
Identified debt-creating flows	-1.1	-0.9	2.7			8.4	0.4	1.7	1.1	1.0	1.1		-1.7	-2.7	
Primary deficit	1.8	3.2	1.6	1.1	1.3	3.5	1.9	3.6	2.9	2.7	2.5	2.8	0.0	-1.5	-0.5
Revenue and grants	10.8	10.9	12.4	14.2	3.5	12.4	13.5	13.8	14.2	14.4	14.8	13.9	15.4	15.3	15.7
of which: grants	1.2	1.3	2.3	3.5	2.9	2.1	2.6	2.5	2.4	2.2	2.1	2.3	1.5	0.6	1.2
Primary (noninterest) expenditure	12.6	14.1	14.0	15.3	2.6	15.9	15.4	17.4	17.1	17.1	17.3	16.7	15.4	13.8	15.2
Automatic debt dynamics	-1.6	-1.9	1.0			4.1	-2.1	-2.3	-2.0	-1.8	-1.4		-1.6	-1.2	
Contribution from interest rate/growth differential	-1.0	-0.7	-1.4			-1.4	-2.0	-2.1	-1.9	-1.8	-1.9		-1.9	-1.4	
of which: contribution from average real interest rate	0.0	0.0	-0.3			-0.3	-0.3	-0.4	-0.3	0.0	-0.1		-0.1	0.2	
of which: contribution from real GDP growth	-1.0	-0.7	-1.1			-1.1	-1.7	-1.7	-1.7	-1.7	-1.8		-1.8	-1.6	
Contribution from real exchange rate depreciation	-0.6	-1.2	2.4			5.4	0.0	-0.2	-0.1	-0.1	0.5		...	...	
Other identified debt-creating flows	-1.4	-2.2	0.1			0.8	0.6	0.3	0.2	0.2	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Reduction of domestic arrears	-1.4	-2.2	0.1			0.8	0.6	0.3	0.2	0.2	0.0		0.0	0.0	
Residual, including asset changes	2.2	1.2	-1.5	0.0	1.7	-2.9	-1.0	-3.1	-1.9	-1.4	-0.9	-1.8	1.4	1.6	1.7
Other Sustainability Indicators															
PV of public sector debt	...	...	24.6			27.1	26.6	25.6	25.2	25.1	25.4		26.7	24.8	
of which: foreign-currency denominated	...	...	13.2			17.2	18.0	18.1	18.5	19.1	19.7		20.7	18.6	
of which: external	...	...	13.2			17.2	18.0	18.1	18.5	19.1	19.7		20.7	18.6	
Gross financing need 2/	7.9	10.1	9.4	12.5	13.8	11.5	9.2	10.0	8.5	8.1	7.4	9.1	5.0	4.5	5.2
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	198.1			218.5	197.1	185.6	177.6	173.9	171.5		173.1	162.2	
PV of public sector debt-to-revenue ratio (in percent)	...	...	243.0			262.1	244.1	226.5	214.3	205.2	199.2		191.2	169.1	
of which: external 3/	...	...	130.4			165.8	164.7	159.8	156.8	155.7	154.0		148.0	127.0	
Debt service-to-revenue and grants ratio (in percent) 4/	21.4	22.3	22.3	41.1	67.6	22.9	20.8	18.2	16.0	16.4	15.2	18.2	15.8	19.3	17.4
Debt service-to-revenue ratio (in percent) 4/	24.1	25.3	27.3	66.3	130.3	27.4	25.7	22.2	19.3	19.3	17.6	21.9	17.5	20.1	18.8
Primary deficit that stabilizes the debt-to-GDP ratio	0.7	2.9	0.4	1.4	1.4	-2.0	2.4	5.0	3.7	3.0	2.3	2.4	0.2	-0.4	-0.2
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	3.0	2.3	3.3	2.9	3.5	3.2	4.3	4.4	4.5	4.7	5.0	4.3	5.0	5.0	5.0
Average nominal interest rate on forex debt (in percent)	1.2	1.2	1.5	1.1	0.3	1.4	1.0	0.8	0.9	1.3	1.3	1.1	1.4	2.3	1.8
Average real interest rate on domestic debt (in percent)	1.5	0.7	-2.7	1.0	3.4	-1.0	-0.2	-0.2	0.9	4.7	4.8	1.5	4.8	4.8	4.8
Real exchange rate depreciation (in percent, + indicates depreciation	-2.6	-5.0	10.7	0.2	5.7	23.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.5	5.1	6.6	9.1	3.7	7.6	7.4	6.4	5.7	5.3	5.1	6.3	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percer	-0.9	14.3	2.6	1.6	4.6	17.0	1.2	18.0	2.2	4.9	6.1	8.2	5.5	-5.3	3.5
Grant element of new external borrowing (in percent)	...	...	...	...	...	45.4	37.7	41.6	37.7	36.7	36.8	39.3	34.3	28.4	32.0

Sources: Country authorities; and staff estimates and projections.

1/ General government gross debt

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

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

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 6. Madagascar: Sensitivity Analysis for Key Indicators of Public Debt 2015-35

	2015	2016	Projections 2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
PV of Debt-to-GDP Ratio																					
Baseline	27	27	26	25	25	25	25	26	26	26	27	27	27	27	27	27	27	27	26	26	25
A. Alternative scenarios																					
A1. Real GDP growth and primary balance are at historical averages	27	26	24	22	22	21	22	24	26	28	30	32	33	35	38	40	42	45	47	49	50
A2. Primary balance is unchanged from 2015	27	28	27	27	27	28	30	33	36	38	41	43	45	47	50	52	55	57	59	61	62
A3. Permanently lower GDP growth 1/	27	27	26	26	26	27	28	29	30	31	32	33	35	36	37	39	40	41	42	43	43
B. Bound tests																					
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	27	28	29	30	30	32	32	34	35	36	37	38	39	40	41	42	42	43	43	43	42
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	27	27	25	25	25	25	25	25	26	26	26	26	26	27	27	27	27	27	26	25	25
B3. Combination of B1-B2 using one half standard deviation shocks	27	27	26	26	26	27	28	29	30	31	31	32	33	33	34	35	35	36	35	35	34
B4. One-time 30 percent real depreciation in 2016	27	34	32	31	30	31	30	30	30	31	31	31	31	31	31	32	32	31	31	30	29
B5. 10 percent of GDP increase in other debt-creating flows in 2016	27	34	33	32	31	32	31	32	32	32	32	32	32	32	32	32	32	31	31	30	29
PV of Debt-to-Revenue Ratio 2/																					
Baseline	219	197	186	178	174	172	167	170	172	173	173	173	172	171	171	171	169	165	159	152	162
A. Alternative scenarios																					
A1. Real GDP growth and primary balance are at historical averages	219	195	172	157	148	143	147	160	170	181	190	200	210	222	234	246	256	266	277	284	324
A2. Primary balance is unchanged from 2015	219	206	193	187	188	190	200	219	235	250	264	277	289	303	316	328	337	346	354	359	406
A3. Permanently lower GDP growth 1/	219	199	189	183	183	183	182	190	197	203	209	214	220	226	234	241	246	249	252	253	282
B. Bound tests																					
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	219	208	209	206	208	211	211	221	228	234	239	244	247	251	255	259	260	259	257	252	275
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	219	200	182	174	171	169	164	168	169	170	171	171	170	169	169	169	167	163	158	151	161
B3. Combination of B1-B2 using one half standard deviation shocks	219	201	183	179	180	182	181	188	194	199	202	206	208	211	214	217	217	215	212	207	225
B4. One-time 30 percent real depreciation in 2016	219	250	233	219	211	206	198	200	200	201	201	200	199	199	198	198	196	191	186	179	192
B5. 10 percent of GDP increase in other debt-creating flows in 2016	219	250	237	223	218	214	207	210	211	210	209	207	205	203	202	200	197	191	185	176	187
Debt Service-to-Revenue Ratio 2/																					
Baseline	23	21	18	16	16	15	14	15	15	16	16	17	17	18	19	19	19	19	19	18	19
A. Alternative scenarios																					
A1. Real GDP growth and primary balance are at historical averages	23	21	18	14	13	12	11	13	17	18	19	20	21	23	25	27	28	29	30	31	35
A2. Primary balance is unchanged from 2015	23	21	19	18	17	17	16	18	22	23	24	26	27	29	31	33	34	35	36	36	41
A3. Permanently lower GDP growth 1/	23	21	18	16	17	16	16	17	17	19	19	21	22	23	24	26	27	27	28	27	31
B. Bound tests																					
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	23	22	20	18	20	19	18	19	20	21	21	23	24	25	26	27	28	28	28	27	30
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	23	21	18	16	15	15	14	15	15	16	16	17	17	18	18	19	19	19	19	18	19
B3. Combination of B1-B2 using one half standard deviation shocks	23	21	19	16	14	17	16	17	18	18	18	20	21	22	22	23	24	24	24	23	25
B4. One-time 30 percent real depreciation in 2016	23	23	22	20	20	19	18	19	20	21	21	22	23	24	25	26	26	26	26	25	28
B5. 10 percent of GDP increase in other debt-creating flows in 2016	23	21	22	32	19	20	16	17	19	19	19	20	21	22	22	22	22	22	22	21	22

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Statement by the Staff Representative on Republic of Madagascar
November 18, 2015

1. This statement reports on new developments since the staff report was issued:

- Since the discontinuation of all buyback operations in the foreign exchange market in early September (a continuous structural benchmark under the staff-monitored program), the official exchange rate has been determined exclusively by market transactions and has remained relatively stable in October and the first half of November. From end-September to November 10, the central bank made cumulative purchases of foreign exchange in the market of about US$18 million, in keeping with its objective of gradual reserves accumulation.

- The draft revisions to the 2015 budget and the draft 2016 budget were submitted to parliament on October 30. The two draft budget documents included all of the agreed revenue measures in paragraph 18 of the MEFP, and the related prior action (MEFP Table 2) has been completed. In addition, the draft 2016 budget law provides for the setting up of an escrow account at the Central Bank for the reimbursement of VAT refunds starting in January 1, 2016 (structural benchmark). The main parameters of the draft budget are in line with those assumed for the staff-monitored program.

Statement by Mr. Yambaye, Executive Director for Madagascar
and Mr. Ismael, Senior Advisor to Executive Director
November 18, 2015

My Malagasy authorities would like to thank staff for the constructive and candid discussions during their mission to Antananarivo in September 2015. They very much appreciate staff's awareness and understanding of the fragile domestic situation and the constraints facing the country. Their policy advice to reverse the deteriorating economic and financial situation and place the country on a firm and sustainable growth path is also valued.

Madagascar's efforts at reforms were severely affected by a number of exogenous shocks in 2015. After receiving Fund support under an RCF in June 2014 to meet urgent balance of payments needs, Madagascar, with Fund technical assistance, started to put in place reform measures aimed at strengthening macro stability and laying the foundation for broader reforms that could lead to Fund support under the Extended Credit Facility (ECF). However, starting in late 2014 and continuing in 2015, the country was hit by a number of domestic and external shocks which constrained the authorities' reform efforts.

The unexpected shocks made it difficult to achieve fully the economic objectives set. A sharp fall in the international prices of mining products severely affected the mining sector. Cyclones and heavy rains in the central part of the country earlier in the year caused agricultural output to decline, and led to the displacement of 39,000 people. Prolonged drought in the south required food assistance for over 200,000 persons. The tourism sector and part of external trade were also affected by these factors, as well as by a lengthy strike at Air Madagascar, the national carrier. The damages from the severe weather are estimated to be equivalent to about 1 percent of GDP, with reconstruction costs projected at about 3 percent of GDP. As a result, growth which had been projected to reach 5 percent in 2015 has now been revised downward to 3.2 percent.

In response to this challenging environment, the authorities maintained and even strengthened the reform efforts which have helped to maintain stability and sustainability. Thus, in the fiscal sector, additional measures were taken to strengthen tax and customs administration, minimize the significant revenue shortfalls versus the 2015 budget, and avoid serious spending overruns. Unavoidable increases in transfers to state-owned enterprises were partially offset by measures to reduce fuel subsidies, clean up the civil service payroll, achieve some cost-savings on current spending and defer non-priority capital spending. These measures yielded significant savings. In addition enhanced monitoring at JIRAMA, the electricity and water public enterprise, has helped reduce transfers from1.7 percent of GDP in 2014 to 0.6 percent in 2015. As a result of these efforts, the increase in the fiscal deficit has been contained and is projected to increase only slightly in 2015 compared to original projections. However, tighter than expected financing conditions affected the arrears clearing plans. Nevertheless, negotiations have started with creditors to settle arrears through the use of treasury bills and they have continued to work on solutions to resolve the issue. Monetary and exchange rate policies have remained on track and have kept inflation in single digits, and the central bank proceeded with a number of reforms to strengthen its capacity. The central bank has also stopped buyback transactions in the interbank foreign exchange market, such that the official exchange rate has now converged to the market exchange rate, after a depreciation of about 10 percent in September.

These shocks worsened the already difficult external position, and have led to urgent balance of payments needs for 2015. My Malagasy authorities are therefore requesting an immediate support from the Fund in the form of a disbursement under the RCF in an amount equivalent to 25 percent of quota. The RCF will be accompanied by a 6-month Staff-monitored Program (SMP). In their Memorandum of Economic and Financial Polices (MEFP), the authorities describe the policies they have been implementing this year and those they plan to implement in 2016, but especially over the next six months in the context of the SMP and cover the period from end-September 2015 to end-March 2016. The RCF will also play a catalytic role in mobilizing donors' support, and is viewed by the authorities as laying the groundwork towards an ECF.

Outlook and Policies for 2016

The policies envisaged under the SMP aim at addressing fiscal weaknesses, preserve macroeconomic stability, support better governance and build the foundations for sustainable growth. The program is consistent with the authorities' National Development Plan (NDP) covering 2015-19 and the Presidential Plan of Urgent Action (PPUA) for 2015-16. For 2016, absent any major shock, the economy is projected to grow by 4.3 percent, mainly on the basis of higher agricultural production, a recovery in textiles export and tourism and some infrastructure investments. However, with the aim of achieving a higher and sustained growth, the authorities are working closely with development partners and external private investors to finance much needed public investment. Inflation is projected to remain at around 7 percent, and the fiscal deficit to be reduced to 3.2 percent of GDP. The authorities also expect an increase in the level of international reserves.

The Fiscal Sector

The 2016 Budget that has been submitted to the National Assembly envisages an increase in revenue equivalent to about 0.6 percent of GDP (including a one-off operation for the regularization of tax arrears of Air Madagascar) and better

prioritization of expenditure. The fiscal deficit on a commitment basis is 2016 is budgeted to decline to 3.2 percent of GDP. The increase in revenue is expected to come from new measures to improve tax administration, strengthened efforts to ensure compliance, measures to reduce fraud, and elimination of some exemptions. Additional revenues are expected from new measures such as a uniform ten percent excise duty on all imported new vehicles, an increase in excise duties on alcoholic beverages and soft drinks, and a tourist arrival fee, among others. Vitally important efforts to strengthen revenue administration, which are already underway, will be further strengthened. As regards expenditures, the authorities will eliminate fuel subsidies, continue the process of cleaning the government's payroll and reduce transfers to loss-making enterprises. The authorities expect that the measures envisaged, especially the reduction in subsidies for fuel and to state enterprises will enable an increase in expenditure in priority areas such as agriculture, education, health and infrastructure.

The authorities are also addressing the issue of payment arrears. In spite of their best intentions, they were not able to progress on this issue, due in part to the unexpected economic and financial shocks. They are however committed to solve the issue and are developing a framework, based on the recommendations of the recent IMF technical assistance, to prevent the emergence of new arrears and settle the existing stock, including arrears related to VAT refunds. Starting in January 2016, an escrow account will be created at the central bank to ring fence the resources required for VAT reimbursement. Also with the support of the African Development Bank, the authorities are developing a PFM reform strategy for 2016-20.

The authorities recognize the importance of improving revenue performance and controlling financial losses in state-owned enterprises, in particular, for JIRAMA and Air Madagascar. They are working closely with the World Bank to reform these two enterprises. As regards JIRAMA, a consultant has been hired to develop a management improvement plan, which includes the organizational restructuring of the company. A program of on-site audits of the largest users (1000) has started, and the authorities are looking into the use of advanced metering for new customers to minimize losses. Steps are also being taken to reduce costs, in particular, the rehabilitation of heavy fuel oil generating units and the auditing of supplier contracts. Air Madagascar has been a major drain on the finances of the state and the authorities are taking strong measures not only to improve the company's financial position, but to rebuild the company so that it can be internationally competitive. In this regard, the Management and Board of the company were replaced, and the new team is working with the World Bank to contract external expertise to restructure the company and develop a new business plan under a new Chairman.

Monetary Policy

The central bank will pursue a prudent monetary policy aimed at keeping inflation at around 7 percent, maintaining a flexible exchange rate and improving the level of international reserves. In this regard, it will use Treasury bill sales and weekly deposit auctions to achieve liquidity targets. The reference interest rate will be allowed to fluctuate more and reflect movements in the money market.

Steps are also being taken to strengthen the independence of the central bank and improve its governance and controls. A revised Central Bank Act will be submitted to the Cabinet for approval before the end of the year, and it includes, among others, clauses that provide for an effective mechanism for the automatic transfer of central bank losses and profits to the government; a phased reduction of statutory advances from the central bank; and establishment of an Audit Committee of the Board of Directors. Moreover, all outstanding central government obligations owed to the central bank will be settled through issuance of interest-bearing instruments, which should improve the financial position of the central bank.

Financial Sector

Reform of the financial sector will continue. An action plan will be finalized following the completion of the Financial Sector Assessment Program (FSAP) that is currently underway. In the meantime, the central bank is taking steps to improve the supervision of foreign-owned banks, finalize the law regulating mobile banking and completing the revision of the Financial Sector Law, including the establishment of a stock exchange in 2016. The authorities are also working with the World Bank to reform and strengthen the supervision of the microfinance sector.

Medium-term Objectives

Over the medium term, the objective remains durable poverty reduction with strong, sustainable growth in a stable macroeconomic environment. In this regard, the authorities are pursuing efforts at national reconciliation, taking steps to strengthen institutions to improve governance and create a conducive environment for private sector development. An important factor towards this development is the existence of good infrastructure for which there is a very large need. The country, however, has very limited resources to undertake these investments and meet the objectives set out in the NDP. The authorities are therefore developing a carefully prioritized plan of the most important projects. They are also exploring all financial options, including Public-Private Partnerships (PPPs). Already a number of potential projects that can be implemented with PPPs have been identified. In order to minimize budgetary risks, a policy and legal framework for PPPs is under preparation and expected to be enacted by year-end. The authorities are also giving a very high importance to improving governance and the fight against corruption. In this regard, a national strategy against corruption has been put in place and the authorities have increased budget allocation for the agencies dedicated to the fight against corruption. Additional measures, as outlined the MEFP will be implemented gradually over the medium term. The authorities also expect that additional financial assistance will be received from developing partners at the Donors' Conference that they plan to hold early next year, and for which the RCF will play a catalyzing role.

Conclusion

The measures outlined above and described in the Memorandum of Economic and Financial Policies demonstrate well the commitment of my Malagasy authorities to address the constraints the country faces. In spite of the challenging environment, the authorities are of the view that they have established an adequate track record in support of macroeconomic stability and sustainability. They remain fully determined to pursue the major reform efforts needed to improve the economic and financial situation of the country and place it on a strong and sustainable growth path. In this endeavor, they are hopeful that their efforts will receive the strong support of the international community. In view of the needs of the country, the commitment of the authorities to reforms and the policy objectives outlined above, I would greatly appreciate Directors' support for my Malagasy's authorities request under the RCF.