August 2002
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Malawi: 2002 Article IV Consultation and Economic Program for 2002—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation and Economic Program for 2002 with Malawi, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation and Economic Program for 2002, prepared by a staff team of the IMF, following discussions that ended on **May 14, 2002**, with the officials of Malawi on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 19, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **July 29, 2002**, updating information on recent economic developments.

- the Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during the August 5, 2002 Executive Board discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Joint Staff Assessment of the Poverty Reduction Strategy Paper
Letter of Intent*
Memorandum of Economic and Financial Policies*
Mission Concluding Statement
Poverty Reduction Strategy Paper
Report on the Observance of Standards and Codes—Fiscal Transparency Module
Selected Issues and Statistical Appendix
Technical Memorandum of Understanding*

*May also included in the Staff Report.

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

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

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INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the 2002 Article IV Consultation and Economic Program for 2002

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by Michael Nowak and Shigeo Kashiwagi

July 19, 2002

- Discussions on the Article IV consultation and the first review under the Poverty Reduction and Growth Facility (PRGF) were held in Lilongwe and Blantyre during February 26-March 13, 2001; May 7-16, 2001; July 12-24, 2001; November 4-22, 2001; February 25-March 10, 2002; and April 29-May 14, 2002; discussions were also held in Washington during October 11-12, 2001; and February 4-6, 2002. The Managing Director met with President Muluzi in Washington, D.C. on February 5, 2002.
- The Fund staff teams included Alfred Kammer (head), Kristina Kostial, Johan Mathisen, Matthew Odedokun (all AFR), Arnold McIntyre and Helaway Tadesse (PDR), and Thomas Baunsgaard and James Brumby (FAD). Thomas Gibson and Girma Begashaw (Resident Representatives) also contributed to the missions. James Munthali and Anna Muganda from the Malawi Executive Director's Office participated in some of the discussions. Members of the World Bank and the African Development Bank staff worked closely with the Fund, including through joint missions.
- The Fund teams met with President Muluzi, Vice-President Malewezi, Ministers of Finance Chikaonda and Jumbe, Reserve Bank Governor Ngalande, other ministers, and senior government and central bank officials, as well as donors, civil society organizations, business groups, financial institutions, and the media.
- In concluding the 2000 Article IV consultation and approving the request for a three-year arrangement under the PRGF, Directors noted with concern that macroeconomic stability had proved elusive, growth had been inadequate, and a large proportion of the population remained in poverty. They welcomed the authorities' renewed commitment, but they stressed that achievement of the inflation target would require the steadfast implementation of policies and, in particular, depend critically on fiscal restraint and resistance to pressures on wages and other recurrent expenditure. Directors also stressed the importance of improved targeting of government spending toward the poor and urged the authorities to step up expeditiously the monitoring and control of parastatals. While acknowledging the recent initiatives to improve governance, Directors strongly urged the authorities to follow through vigorously on all investigations and prosecutions of fraud and corruption cases.
- Malawi has accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Articles of Agreement and maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions.

Contents

EXECUTIVE SUMMARY

Recent developments

The disinflation program has been broadly successful, but a prolonged period of expansionary fiscal policy crowded out private sector activity. The monthly nonfood consumer price inflation has declined sharply and remained below 10 percent since February 2001, but it did pick up somewhat at the beginning of 2002. At the same time, real interest rates remain high, reflecting an expansionary fiscal policy and protracted inflation expectations. Malawi's growth performance remains disappointing, with agricultural output stagnating and private sector activity weak.

While monetary policy has been tight, fiscal policy has been too expansionary. The targeted domestic fiscal deficit for 2000/01 (July-June) was exceeded by 3½ percent of GDP, and for 2001/02 it is projected to be exceeded by almost 7 percent of GDP.

Report on policy discussions

Policy advice through 2001 and 2002 was guided by the PRSP process, which early on recognized that only higher and sustained economic growth could reduce poverty.

The new Minister of Finance, who took office in January 2002, has publicly acknowledged that a decisive turnaround in fiscal policy is needed to halt the increase in public debt and to create an environment conducive to private sector-led growth. The 2002/03 budget is expected to involve significant adjustment, reducing the domestic deficit to 5½ percent of GDP from 8 percent of GDP in 2001/02. The size of the adjustment, compared with 2001/02, is ambitious; however, it has to be viewed in the context of the need to reverse a highly expansionary fiscal stance in the two preceding years and to bring the domestic debt situation under control. In support, the authorities will improve the monitoring and control of parastatals and accelerate efforts to strengthen expenditure management.

The Reserve Bank of Malawi (RBM) will maintain a tight monetary policy. The authorities stressed that the exchange rate would continue to be market determined, with the RBM's intervention in the foreign exchange market limited to meeting the gross reserves target and moderating short-term fluctuations, without attempting to influence underlying market trends. The financial sector has been under some strain but remains sound.

Malawi's most pressing issue now is to address a major food shortage expected for later this year in order to avert malnutrition and starvation. Donor pledges for humanitarian aid broadly cover the requirement identified by the FAO/WFP. Moreover, to close the remaining food gap, the government will import maize, which it will provide at a subsidized price.

Malawi's economic data suffer from many serious deficiencies which hamper the authorities' and the staff's efforts to conduct accurate and timely policy analysis. Moreover, public dissemination of data is deficient and subject to long delays. The staff has assisted the authorities to improve official data, but sustained efforts are needed by the authorities to make lasting progress in the data quality and timeliness.

I. Introduction

1. Discussions with the Malawian authorities on the 2002 Article IV consultation took place between November 2001 and May 2002. These discussions also focused on bringing back on track the economic program supported under the Poverty Reduction and Growth Facility (PRGF), which was approved by the Board in December 2000 (EBS/00/263, 12/11/00).[1] In light of the severe policy slippages since approval of the arrangement, a record of strong policy implementation through September 2002 will be needed before the staff can propose to the Board the completion of the first review under the PRGF. To this end, the authorities have outlined their policies in 2002 in the attached letter of intent (LOI) to the Managing Director, dated July 19, 2002 (Appendix I). Malawi's relations with the Fund are summarized in Appendix II. A Report on the Observance of Standards and Codes (ROSC) is being issued concurrently with this staff report. A safeguards assessment was finalized in July 2001.

2. Malawi's economic program was guided by the poverty reduction strategy paper (PRSP) process. The program has been designed in close collaboration with the World Bank and other members of the international community. Malawi's relations with the World Bank Group are summarized in Appendix III. A joint staff assessment (JSA) of the PRSP is being issued concurrently with this staff report.

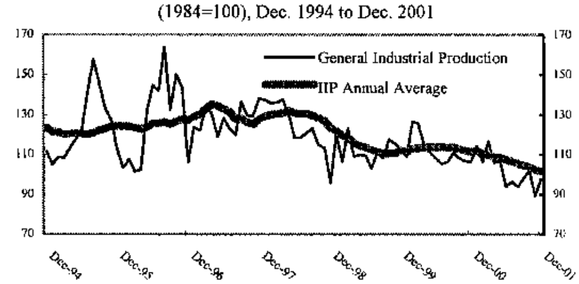
3. Malawi's core economic databases are weak, and the authorities will have to address serious deficiencies more forcefully. Malawi's participation in the Fund's General Data Dissemination System (GDDS) Anglophone Africa project is designed to assist the country in developing statistical systems to meet GDDS recommended practices. Statistical issues are detailed in Appendix IV. Appendix V reports selected social and demographic indicators.

II. Recent Developments and Performance Under the Program

A. Macroeconomic Developments

4. **Growth performance was disappointing in 2001, with real output likely to have contracted (Table 1). For 2002, preliminary agricultural production data point at best to a weak economic recovery.** Agricultural output in 2001 was depressed by a drop of one-third in maize production (Box 1). Growth in the manufacturing and services sectors remained negligible, reflecting not only the impact of the low agricultural output on agro-processing, but also high real interest rates, which encumbered private

Figure 1. Index of Industrial Production, Actual and Annual Average (1984=100), Dec. 1994 to Dec. 2001



[1] A Board paper for the first review of the PRGF (EBS/01/90, 6/14/01) was circulated but not considered by the Board as the meeting had to be suspended owing to slippages in the program.

Box 1. The Food Crises

Malawi's current food situation is serious. Although the crisis early this year was temporarily alleviated by the April-June 2002 harvest, large shortages are expected for later in the year. Thus, urgent action is needed to prevent malnutrition and starvation, and the authorities, together with the international donor community, are fleshing out an appropriate response. The delays in responding to the food crisis in early 2002 were due to a failure of the early warning systems, which form an integral part of the government's food security policy.

The causes of the food shortages are complex. Although precipitation was normal on average in 2000/01 and 2001/02, uneven rainfalls with dry spells and floods reduced yields substantially. Producer prices were depressed in 2000/01 when the government sold its grain reserve to the domestic market after a bumper harvest, leading to defaults on agricultural credit, insufficient income to purchase fertilizer and hybrid seeds, and, thus, reduced output. Moreover, as part of the coping strategy at the beginning of 2002, crops were harvested prematurely, reducing output in April 2002-March 2003 further.

The implementation of the food security policy failed when two elements did not perform:

- **The early warning systems did not signal a crisis.**[1] While the systems predicted a maize shortfall in 2001, they relied on flawed agricultural statistics, which indicated that the shortfall would be more than compensated for by an increase in other food crops. The failure of the systems became apparent only in February 2002, when the country ran out of food.
- **The National Food Reserve Agency (NFRA) had sold virtually the entire maize stock by the beginning of 2001 and could not replenish the reserve, owing to the bad harvest in 2001.** It was, however, generally acknowledged that it was necessary to rotate the grain reserve, that is, to sell deteriorating maize but to purchase in parallel fresh maize.

Moreover, the strategy to improve the transparency of maize operations, stop price distortions, and reduce the costs to the budget failed:

- **Transparency.** The Agricultural Development and Marketing Corporation (ADMARC), which continued to operate the strategic grain reserve on behalf of the NFRA, sold 68,000 metric tons between August 2000 and January 2001, without authorization but also likely without the knowledge of the NFRA management. These types of transactions were a persistent problem also during the period of the Enhanced Structural Adjustment Facility (ESAF) arrangement. Moreover, there have been allegations in the news media that some of the maize went to politically connected people at below-market prices. An audit by the Auditor General has been conducted, and the Anti-Corruption Bureau has started an investigation. Donors are insisting on an external audit, and the government has agreed.
- **Price distortions.** Most of the maize sales by ADMARC and the NFRA from mid-2000 to January 2001 went to the domestic market. These transactions depressed maize prices further after the 2000 bumper harvest, thus creating disincentives for producers and contributing to the shortages in early 2002.
- **Costs to the budget.** The budget was derailed in 2000/01 (July-June), inter alia, when the government bailed out the NFRA by repaying its commercial loans (the budget only included funds for servicing the debt, and not for full repayment). Furthermore, budgetary support amounting to 1½ percent of GDP was provided to ADMARC during 2000 and 2001.

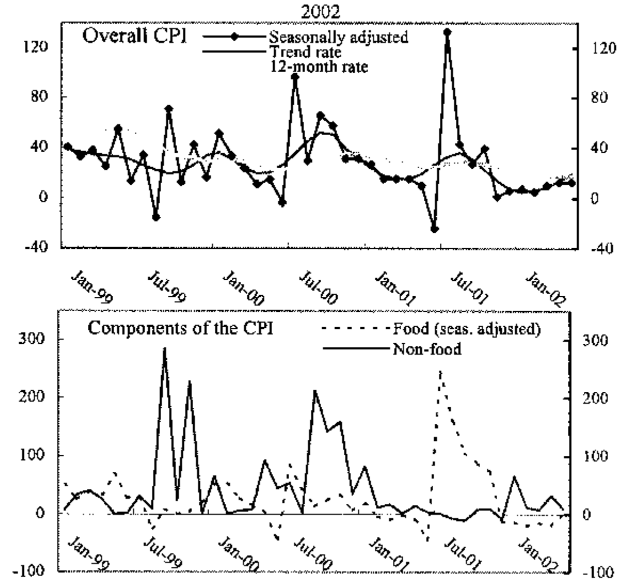
The food crises, however, also point to a failure of Malawi's agricultural policies. One problem is Malawi's overreliance on maize. Maize is not drought resistant and requires fertilizer as it exhausts soil nutrients quickly; in addition, to maintain yields, fresh hybrid seeds are required on an annual basis. The diversification into other food crops appeared to have been one of the achievements in agricultural policy. However, the data now suggest that the extent of the diversification was much smaller than previously believed. Moreover, government interventions in the food market, including through free agricultural inputs, have not led to the expected sustained increase in farmers' income.

[1] A combination of systems is in place, including the monitoring and forecasting of weather and crop production by satellite. The systems are complemented by assessments on the ground, including by missions.

sector activity in general.[2] Industrial activity shrank to its lowest level in more than a decade (Figure 1). While 2002 harvest data indicate a further decline in maize production, of 6 percent from 2001, the output of other crops, including tobacco, appears to have increased.

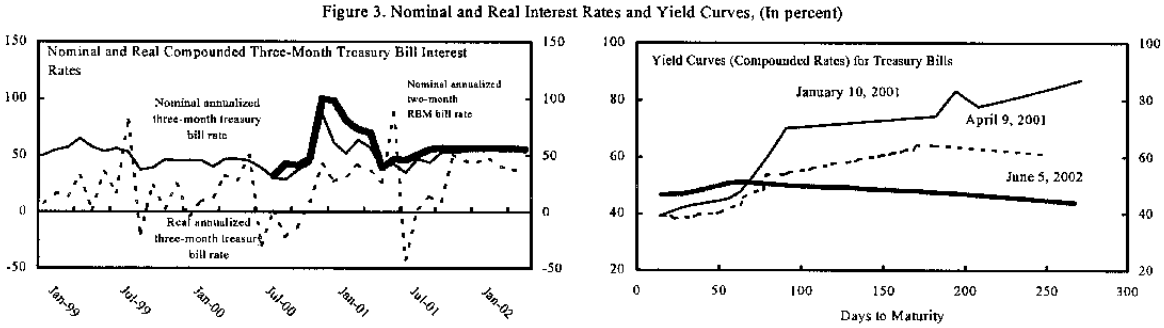
5. **The disinflation program, however, has been broadly successful. Since end-2000, inflation has fallen considerably, reflecting the tight monetary stance (Figure 2).** The annualized monthly inflation rate declined sharply to below 10 percent in seasonally adjusted terms in February 2001 from 40 percent in December 2000. While nonfood inflation remained below 10 percent throughout 2001, food prices, in seasonally adjusted terms, rose by 40 percent between July and October 2001, when the final agricultural statistics confirmed the decline in domestic maize production and prices adjusted to import parity levels.[3] Nonfood inflation picked up in early 2002, reflecting, inter alia, the pass-through of the depreciation of the kwacha. The headline 12-month inflation rate declined throughout the period to 17 percent in May 2002.

Figure 2. Malawi: Monthly CPI Inflation, January 1999 to May 2002



6. **Real interest rates remain high at over 30 percent, owing to an expansionary fiscal policy and persistently high inflation expectations (Figure 3).** Following a sharp increase at end-2000 in response to monetary

Figure 3. Nominal and Real Interest Rates and Yield Curves, (In percent)



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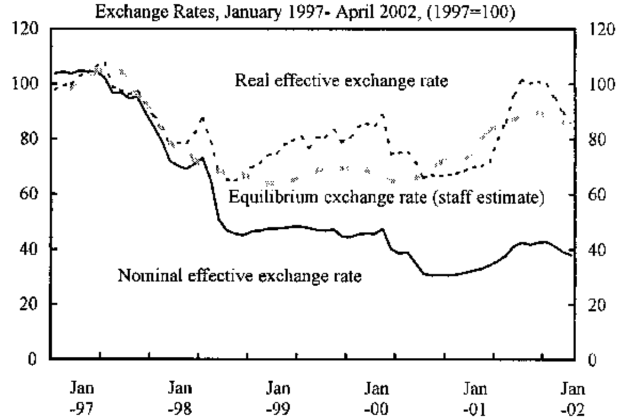
[2] Credit to the private sector declined in real terms by 5 percent between December 2000 and April 2002.

[3] Domestic maize prices can deviate substantially from world market prices, given the high transportation costs. For example, in late 2001, import and export parity prices were MK 15 and MK 5 per kilogram of maize, respectively. Owing to supply bottlenecks in importing maize, prices in private markets in early 2002 exceeded import parity by up to 100 percent.

tightening, real interest rates fluctuated between 30 percent and 70 percent during 2001-02, except for a short period in 2001 when food prices rose. Inflation expectations remain deeply entrenched because of a history of stop-and-go disinflation episodes that has undermined the credibility of the Reserve Bank of Malawi (RBM)'s disinflation effort. While the inversion of the yield curve indicates a moderate decline in inflation expectations, these expectations have not yet been fully realigned with the actual decline in inflation, thereby raising concerns about output costs.

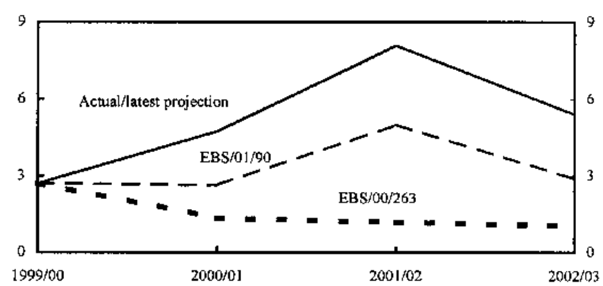
7. **The kwacha appreciated sharply in real effective terms during 2001, although the year-on-year appreciation was moderate (Figure 4).** The sharp appreciation reflected not only a correction of the large real depreciation during 2000, but also the fiscal expansion and, later in the year, the depreciation of the South African rand. However, while the rate appreciated by over 50 percent during the year, the year-on-year appreciation was less than 7 percent. Following some depreciation in early 2002, the real exchange rate appears now to be broadly aligned with its estimated equilibrium rate (see Selected Issues and Statistical Appendix, forthcoming).

Figure 4. Malawi: Real and Nominal Effective and Equilibrium Exchange Rates, January 1997- April 2002, (1997=100)



8. **Fiscal policy has been considerably more expansionary than programmed, leading to a crowding out of private sector investment (Figure 5 and Table 2).** The slippages in 2000-02 came mostly from policy decisions to bail out parastatals, augment civil servants' wages, increase other low-priority public spending, such as travel and representation, and reduce income taxes. These slippages were exacerbated by a rising interest bill and weak revenue collections owing to a decline in firms' profitability and sluggish collection of import-related revenue. As a result, the program target (EBS/00/263) on the domestic budget deficit for 2000/01 (July-June)[4, 5] was exceeded by about

Figure 5. Domestic Deficit, 1999/00-2002/03; (in percent of GDP)



[4] The domestic budget balance is defined as revenue, excluding grants, minus expenditure, excluding foreign interest and foreign-financed development projects. It attempts to measure the direct impact of government operations on domestic absorption. However, in Malawi this measure is only approximate. For example, foreign-financed projects, which are excluded from the measure, usually have a domestic component as well.

[5] The authorities accommodated spending pressures in 2000/01, and the domestic deficit widened to 4.7 percent of GDP from 2.7 percent of GDP in 1999/2000. Although the authorities intended to curtail expenditure by tightening guidelines for domestic and foreign travel, rationalizing car fleet management, and reducing

(continued)

3½ percent of GDP and that for 2001/02 is projected to be overrun by almost 7 percent of GDP.

9. **Monetary policy has been the cornerstone of the stabilization effort.** For the most part, the RBM has since December 2000 followed a tight monetary stance. While there have been expansionary bouts when the RBM did not fully sterilize large drawdowns of government deposits and larger-than-programmed purchases of foreign currency, the liquidity impact was muted by the buildup of excess reserves in the banking system (Figure 6 and Tables 3 and 4). For June 2002, however, the indicative target for reserve money, the RBM's operational monetary target, was exceeded by about 3 percent.[6]

10. **The external current account deficit narrowed to 13 percent of GDP in 2001, down from some 14 percent in 2000 (Table 5).** A small deterioration in the trade balance was more than offset by an improvement in the services balance. Export receipts were virtually unchanged from 2000, as a drop in receipts on tobacco exports due to lower prices was offset by an increase in exports of tea, sugar and coffee. Import demand remained compressed and recovered only slightly from the large drop in 2000, despite the real exchange rate appreciation and expansionary fiscal policies, reflecting the sluggish economy. The services balance improved, owing mostly to lower public interest payments (before debt relief). Despite the suspension of balance of payments support by most donors at end-2001, international reserves remained adequate and stood at about 3 months of imports at end-June 2002.

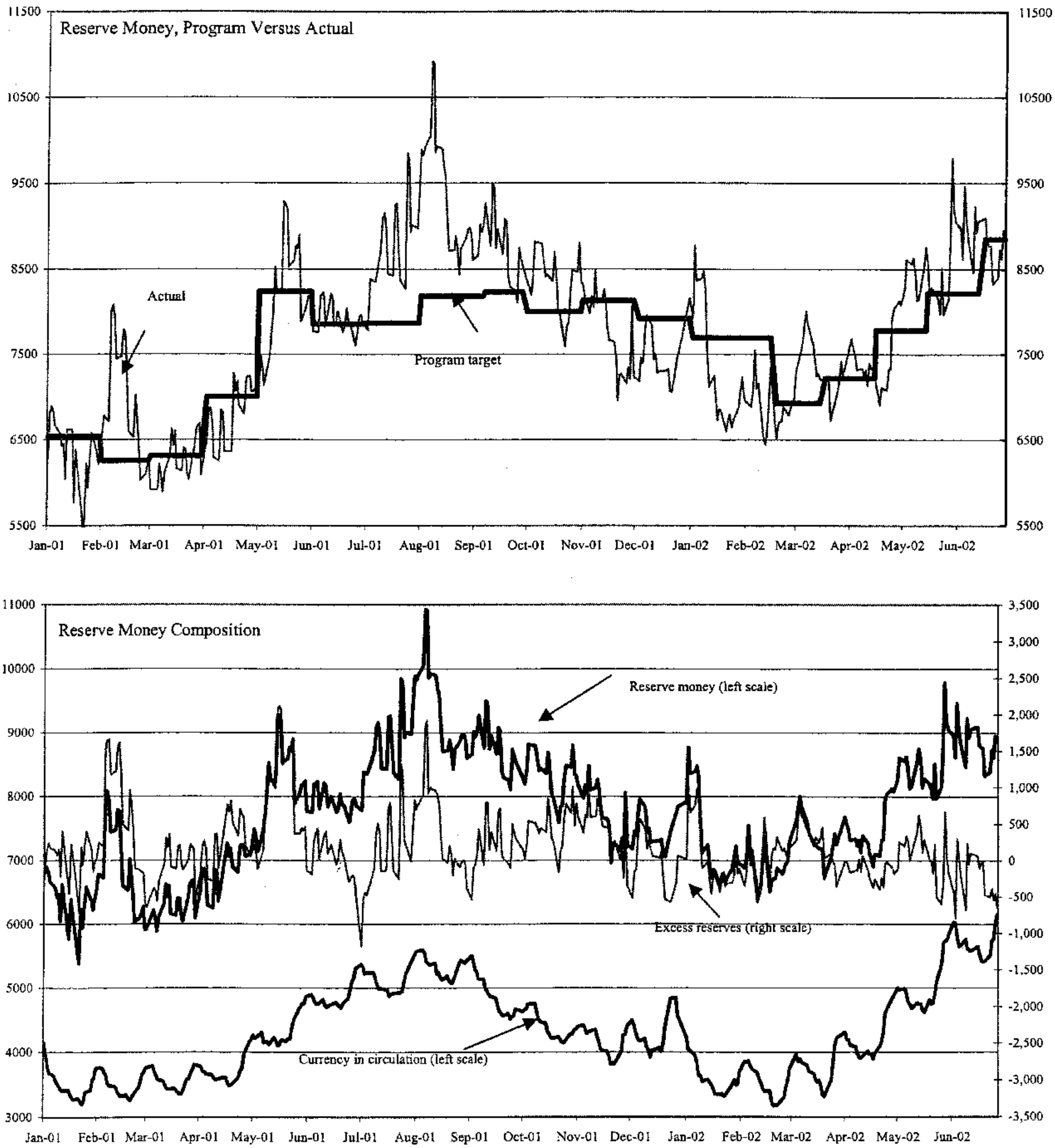
B. Food Crisis

11. **Malawi experienced a severe food crisis in early 2002, resulting in widespread malnutrition and starvation. A response to the food crisis was delayed, as early warning systems, which are an integral part of the government's food security policy, failed (Box 1 and EBS/02/120, 7/3/02).** While it was known from around mid-2001 onward that the harvest was insufficient to cover the annual consumption of maize, agricultural data showed large increases in the production of other food crops, thereby indicating an overall food surplus of over 400,000 metric tons (maize equivalent). As maize is the main staple food, however, the National Food Reserve Agency (NFRA) on behalf of the government started in October 2001 to import 150,000 metric tons of maize to ensure that prices for maize would remain stable. When these imports were delayed because of transportation bottlenecks and actual production of other crops turned out to be far below what had been estimated, it proved too late to provide sufficient food. The impact of the food shortages in early 2002 was devastating, particularly for those infected with HIV/AIDS. While the maize imports were sold at a subsidized price through the Agricultural Development and Marketing

spending on local rents, foreign affairs, and state residences—all categories where chronic overspending had taken place—measures were implemented only partially.

[6] Reserve money is measured as the average daily balances over the quarter.

Figure 6. Malawi: Reserve Money, Actual Versus Program, and Composition of Reserve Money, January 2001-June 2002, (In millions of kwacha)



Sources: RBM; and staff estimates.

Corporation (ADMARC),[7] they were rationed, owing to breaks in the supply pipeline; market prices were sharply higher.

12. **Although the immediate crisis has been temporarily alleviated by this year's harvest, the start of relief operations and the expansion of social safety net programs, large food shortages are expected for later in 2002 and the beginning of 2003.** The Food and Agriculture Organization (FAO)/World Food Program (WFP) project an import requirement of 485,000 metric tons of maize (equivalent to 20 percent of annual cereal consumption) (see also paragraphs 36-39). An estimated 3.2 million people (or 30 percent of the population) are expected to require humanitarian aid, equivalent to 208,000 metric tons. The FAO/WFP expect that the remainder of 277,000 metric tons will be imported commercially.

C. Structural Reforms, Governance, and the PRSP

13. **Progress in implementing structural reforms has been slow, but it gained momentum recently when the large parastatal bailouts from the budget highlighted the need for action (Table 6 on the structural components of the PRGF and Box 2).** The Ministry of Finance and Economic Planning has gained more control over the parastatals since the Public Enterprise Reform and Monitoring Unit (PERMU) became operational[8] and

Box 2. Parastatal Reforms and Costs

Malawi's portfolio of parastatals remains large despite the launching of a privatization program in 1996. The original framework envisaged that all parastatals of a commercial nature should be targeted for immediate privatization, those not viable or redundant should be liquidated or dissolved, and those that were inappropriate for privatization for strategic reasons (that is, related to defense, health, education, and the environment) or because of a lack of regulatory framework (e.g., public utilities) should be managed on a fully commercial basis and considered for future privatization. However, these reforms were not implemented, and, as parastatals continued with their operations, their fiscal and economic costs have diverted resources from priority programs.

Four types of costs from the parastatal sector have had fiscal implications in 2000-02: direct bailouts of external and domestic contractual obligations of ADMARC (equivalent to 1.6 percent of GDP between August 2000 and July 2001) and the NFRA (equivalent to 1.6 percent of GDP between February 2001 and December 2002); arrears on on-lent loans (0.4 percent of GDP annually); loans directly assumed by government (0.4 percent of GDP annually); and tax arrears (0.3 percent of GDP annually). Contingent liabilities through external loans amount to 2.5 percent of GDP. Moreover, inefficiencies in the operations and activities of parastatals cause a loss of tax and dividend revenue and generally lower income levels, owing to inefficient allocation of resources.

[7] The price was set at import parity of MK 17 per kilogram as of December 2001. However, owing to the subsequent depreciation of the kwacha, the NFRA incurred losses of about MK 500 million (0.4 percent of GDP) when selling maize at an unchanged kwacha price. A transfer to the NFRA to compensate for these losses has been included in the 2002/03 budget.

[8] PERMU is now fully staffed and produces regularly a quarterly report on the financial performance of the ten largest parastatals.

ADMARC's loss-making subsidiaries, which received substantial transfers in 2001, were transferred under its direct control. Moreover, audits of these subsidiaries, showing large operational inefficiencies, and of the financial and management accounts of ADMARC have been completed. ADMARC's cotton activities were incorporated into a separate entity, and an agreement was reached with a foreign investor on the concession of this company. Finally, the authorities privatized the Commercial Bank of Malawi in December 2001 and, after a suspension of the privatization program in mid-2001, are completing the privatization of Malawi Telecom Limited and Air Malawi.[9]

14. **While the institutional and legal framework has been built up to improve governance, bringing to closure high-profile corruption cases has proved to be protracted.** The Anti-Corruption Bureau (ACB) has gradually widened its involvement and achieved public visibility, but it has yet to obtain a conviction in a high-profile case.

15. **The PRSP was launched on April 24, 2002, evolving from a highly participatory process.**[10] Its strategy relies on a framework consistent with achieving the macroeconomic objectives of the program and presents a balanced approach to creating the necessary conditions to generate growth, improve social sector outcomes, protect the vulnerable, and improve governance. Other strengths of the strategy are its detailed action plan and institutional structure for monitoring the PRSP. However, the strategy does not provide sufficient guidance for policymakers for preparing the central government's budget. Thus, successful implementation of the PRSP will require translating its priorities into the budget as part of the annual budgetary preparations.

D. Political Developments

16. **Malawi's young democracy is experiencing tensions in the run-up to the third presidential election.** The ruling party has been mounting a campaign to amend the constitution to eliminate term limits for the president. Moreover, several legislative changes have been approved that extend the control of the ruling party (such as abolishing the senate or deterring members of parliament from changing their political party affiliation), the freedom of the press has recently come under pressure, and demonstrations with regard to the term limit have been banned. However, parliament rejected in early July a bill eliminating the presidential term limit.

[9] The government has relinquished its majority share in the National Bank of Malawi by selling 3 percent of its ownership to the Press Corporation, which now holds the majority share.

[10] The authorities produced (i) an interim PRSP in August 2000 that outlined the thrust of the poverty reduction strategy; (ii) a "PRSP findings to date" paper in May 2001 that summarized agreed sector-specific priorities and guided the selection of pro-poor spending in the 2001/02 budget; and (iii) a first draft of the PRSP in October 2001.

III. Report on the Discussions

A. Medium-Term Framework

17. **Malawi's poverty reduction strategy aims at reducing the incidence of poverty to 59 percent in 2005 from 65 percent in 1998.** The PRSP clearly recognizes that higher and sustained economic growth is necessary to make a sizable dent in poverty and lays out a four-pronged strategy:

- to promote sustainable pro-poor growth by offering the poor an opportunity to increase their incomes and providing the private sector with an enabling environment for investment;
- to develop human capital, as a healthy and educated population will be more productive, and reduce income inequality, as it restricts the productive potential of the poor;
- to improve the quality of life for the most vulnerable by strengthening their resilience to shocks through social safety net programs; and
- to establish good governance, thereby ensuring that public institutions and systems protect and benefit the poor.

18. **This strategy, in turn, forms the basis of the program (see Box 3 for a poverty and social impact assessment).** The program aims at restoring and consolidating macroeconomic stability as key to moving onto a higher growth trajectory. At the same time, it includes structural reform elements, including on governance, which had earlier jeopardized the stabilization effort and impeded growth. Moreover, the program makes room for a substantial increase in spending on human capital and the provision of transfers to the poor through social safety net programs. While the program is consistent with the PRSP's objectives, the government has updated the macroeconomic framework of the PRSP to reflect higher external financing (and, correspondingly, expenditure) and the provision of a food subsidy.

19. **The medium-term macroeconomic framework envisages by 2005 an increase in real growth to over 5 percent, a sustained reduction in inflation to below 5 percent, and a rebuilding of international reserves to about 4½ months of imports.**[11] The growth target is realistic, based on performance in the past, and necessary to attain the poverty reduction target.[12] After a substantial fiscal adjustment in 2002/03, the fiscal balance is expected to improve further, owing mostly to a smaller domestic interest bill, and make room

[11] These projections take into account the adverse effect of HIV/AIDS on growth, estimated at 1½ percentage points per annum (for more detail see EBS/00/263 (12/11/00) and SM/00/281(12/15/00)).

[12] To reduce the absolute number of the poor, it is estimated that Malawi will have to grow by at least 5 percent per annum, as the income elasticity of the poor with respect to overall growth is less than one.

Box 3. Poverty and Social Impact Analysis (PSIA) of the Program

This box provides a qualitative preliminary assessment of the poverty and social impact of specific policy elements supported under the program. While a World Bank project analyzing the social impact of closing some of ADMARC's retail markets, Malawi will need to start work on a more comprehensive and quantitative analysis of the policies set out in the PRSP.

Promoting rapid, sustainable economic growth and structural transformation.

The PRSP emphasizes that macroeconomic stability is key to pro-poor growth, with the agricultural sector as the engine, as most of the poor are generating their incomes from this sector. The core objectives of the program—to create a stable macroeconomic environment with low inflation and interest rates, and an environment conducive to private sector activity—should thus directly benefit the poor.

While agricultural production is risk prone in nature, macroeconomic instability has introduced further costs and depressed income and growth in several ways. First, agricultural input prices are high, reflecting high financing costs for importers owing to high interest rates and large risk premiums for foreign exchange transactions. Second, as agriculture is subject to long planting and harvesting financing cycles, high interest rates have made microcredits more expensive and further increased production costs. Third, sporadic, sharp devaluations—in particular in 1998 and 2000 right after smallholders had sold their products—led to pronounced income losses and depressed agricultural production, as farmers could buy fewer inputs for the next growing season. For instance, in 1998 alone, the income loss for tobacco farmers, transporters, and sellers is estimated at 4 percent of GDP.

Also structural reform elements of the program are expected to have a positive impact on the poor:

- Not only **ADMARC**'s inefficiencies and monopsony power, but also its uncompensated government-mandated operations, have depressed the farmgate price for cash crops. A World Bank PSIA project focuses on about 200 loss-making markets that are slated to be sold to the private sector to increase market efficiency and, thus, farmers' income. This project will assess the quantitative importance of the markets, and the risk of privatization with regard to market failure, food security, and local political support. It will provide suggestions on how to sequence the market restructuring and guidance on potential private sector interest. In the meantime, a subsidy for maintaining the markets has been included in the 2002/03 budget.
- The large losses in **parastatals** have diverted funds from priority areas. Thus, commercializing, liquidating and privatizing them will free resources for pro-poor spending. While privatization will entail retrenchment in some cases, this will affect mostly middle-income groups. Nevertheless, retrenchment costs have been budgeted to mitigate the impact on laid-off parastatal employees.
- **Wage policy reform** for civil servants will help attract high-caliber staff, and lower attrition rates, which, in turn, will reduce training costs, and improve public services delivery.
- The cut in the personal income **tax** with the 2001/02 budget benefited mostly the highest income earners, but indirectly resulted in an increase in interest rates owing to a higher borrowing requirement. Thus, the reversal of the tax cut will generate resources for pro-poor spending without the need to borrow. Also, the increase in selected excise taxes has been designed so as not to affect the poor.

Enhancing human capital development

The program envisages a substantial increase in spending on human resources, such as primary health care and education, to almost 3 percent of GDP in 2002/03 from 2.1 percent of GDP in 2000/01.

Improving the life of the most vulnerable

Regarding the impending food shortage, while donor pledges cover the ultra-poor one-third of the population, the program makes room for a general price subsidy, which will mostly benefit the poor who do not receive humanitarian aid but cannot afford maize at import parity prices. For the future, the government plans to improve its food security operations and to reduce the vulnerability of the poor to food shocks, with the assistance of the World Bank and other donors.

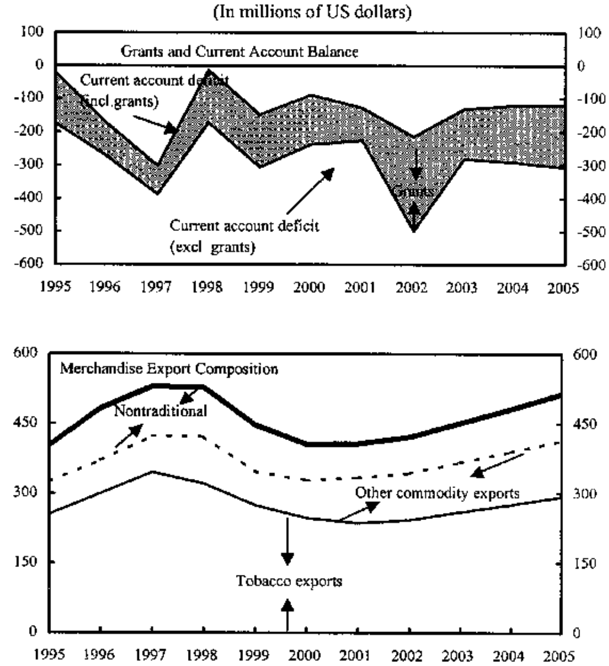
Promoting good governance

Prosecuting offenders in large-scale fraud and corruption cases will reduce the risk of diverting funds from priority programs. Also, reforms in public expenditure management will safeguard the reorientation toward PRSP priorities and will allow civil society to monitor whether, in fact, the poor are benefiting from this reorientation. The costs of mismanagement, fraud, and misappropriation at the Petroleum Control Commission in 1997/98, for instance, are estimated at 3½ percent of GDP.

for a significant increase in private sector credit and investment. Monetary policy will remain geared to achieving the targeted reduction in inflation.

20. **The external current account deficit is expected to widen sharply in 2002, owing to the large-scale maize imports in response to the food crisis, before narrowing in the medium term, in line with higher public and private savings (Figure 7).** Malawi will continue to benefit from sizable aid inflows in the medium term. These aid flows have been projected based on existing donor programs, but could be higher (see, for example, Box 5 below). Moreover, it is expected that donors will continue to shift from project to program support[13] with a strengthening in accountability and transparency in the budget and from loans to grant financing. Moderate growth is projected for nonmaize imports, and export growth is expected to pick up, as nontraditional exports develop and because prospects for both price developments and demand for traditional exports are favorable.[14] The external current account deficit will be more than covered by grants, concessional financing, foreign direct investment, and debt relief under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative). This will also allow for a buildup of international reserves. However, the large-scale commercial maize import requirement in 2002 will give rise to a balance of payments gap of US$60 million in 2003.

Figure 7. Current Account and Exports, 1995-2005
(In millions of US dollars)



21. **The latest medium-term projections reaffirm that Malawi, after receiving debt relief under the enhanced HIPC Initiative, is well placed to attain long-term debt sustainability.** With lower projections for export growth, Malawi's key debt sustainability indicator is somewhat less favorable than projected in the decision point document (see table

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[13] Project support is earmarked, while program support finances general budgetary expenditure.

[14] Nontraditional exports are forecast to grow by an annual average rate of 9 percent over the medium term, reflecting in part the implementation of recent trade agreements and initiatives. These include the Southern African Development Community (SADC) free trade area and the Common Market for Eastern and Southern Africa (COMESA) agreement. Moreover, prospects for increased exports to the U.S. and European Union markets have improved because of recent initiatives to encourage duty-free and quota-free access to these markets under the U.S. African Growth and Opportunity Act (AGOA), the Everything But Arms (EBA) proposal, and other preferential schemes for least developed countries (LDCs) (see Selected Issues and Statistical Appendix, forthcoming).

in Box 4).[15] The net present value (NPV) of debt-to-exports is projected to decline to 165 percent by the end of this decade. The indicator could improve if export growth accelerated as a result of greater efficiency in tobacco-marketing arrangements and increased market access, particularly for textiles and garments under AGOA.

Box 4. HIPC Initiative Debt Relief and External Debt Sustainability Indicators

Malawi is receiving interim relief under enhanced HIPC Initiative from multilateral and bilateral creditors. The World Bank, the African Development Bank, and the European Investment Bank are currently providing relief, while Fund relief for 2002 is pending the conclusion of the first review of the PRGF arrangement. Regarding Paris Club creditors, Malawi has signed formal agreements with Austria, Italy, Spain, Sweden, and the United Kingdom and reached agreement with Germany while discussions are ongoing with France. In the case of Japan—the largest bilateral creditor—Malawi received 2001 official development assistance (ODA) relief in the form of a grant that has been deposited in an account in Japan and can be used for imports for appropriate efforts for the economic development and the enhancement of people's welfare, but not for military use. Discussions on 2001 non-ODA relief and relief for 2002 from Japan are ongoing, and the authorities hope to delink the relief from import financing and treat it the same as any other HIPC Initiative debt relief. Japan intends to respond to Malawi's request, provided that the monitoring system for the appropriate use of such grants is confirmed by Japan. The Paris Club has informed Malawi in January 2002 that the second phase of the agreement covering 2002 has not come into force; this phase is expected to be implemented once the PRGF arrangement is reactivated.

Malawi : Debt Sustainability Indicators, 2001-10
(Ratios in percent)

	2001	2002	2003	2004	2005	2010
Current 1/						
NPV of debt to exports	315.0	332.0	193.7	190.2	184.6	164.6
NPV of debt to revenue	304.5	286.0	153.4	143.8	135.0	98.6
Decision Point						
NPV of debt to exports	309.1	180.7	176.9	171.9	169.0	157.7
NPV of debt to revenue	333.2	174.5	158.0	142.4	132.1	91.6

Source: staff estimates.

1/ Assumes a delay in the decision point to 2003 from the end-2002 date envisaged in the decision point document.

22. **Growth is expected to accelerate gradually over the next few years:**

- In the short term, the recovery should come from improved macroeconomic stability, a reduction in real interest rates, and a rebound in private sector credit.

- In the medium term, growth should be bolstered by the privatization of parastatals, and the accompanying expansion and enhanced reliability of utility services. At the

[15] However, this does not include Paris Club pledges, which exceed Cologne terms.

same time, reforms to government operations should reduce the amount of "red tape" and strengthen the delivery of economic and social services. These measures, together with an improvement in governance, should renew confidence in the public sector and lower the cost of doing business.

- In the long term, growth will be augmented by the benefits of investment in human capital associated with improved health and education.

23. **The engine of the government's pro-poor growth strategy will be the agricultural sector, as most of the poor are engaged in subsistence farming.** Broad-based growth in agriculture would address the dual objectives of food security and income enhancement for the poor. The PRSP specifically recognizes that restoring macroeconomic stability is a necessary condition for growth in the agricultural sector, as high interest rates, high inflation, and sharp devaluations have severely reduced investment and productivity growth.

Box 5. HIV/AIDS

Malawi has been gravely affected by the HIV/AIDS epidemic. While awareness levels have gone up, behavioral change appears to be limited and condom use has spread only slightly. The adult prevalence rate, is estimated at 15 percent (in 2001). HIV/AIDS deaths already account for about 75 percent of adult mortality, and the share is still rising.

Haacker (2002),[1] in discussing HIV/AIDS in southern Africa, stresses that **the demands on the public sector in Malawi will rise further**:

- The epidemic will increase the demand for **health services**, with the number of HIV/AIDS patients expected to double over the next few years. Also the health care staff is affected by the epidemic—it is projected that training for health care staff would have to be expanded by 25-40 percent during this decade to keep the number of personnel constant.

- Although the demand for **education** will fall owing to a declining population and reduced fertility rates, it will be difficult to maintain, let alone improve, pupil-teacher ratios as the proportion of newly trained teachers required to replace the teachers who have died of HIV/AIDS is projected to rise from 27 percent in 2000 to 45 percent in 2010.

Malawi adopted a National HIV/AIDS Strategic Framework to reduce the incidence of HIV/AIDS and other sexually transmitted diseases and improve the quality of life of those infected and affected by HIV/AIDS. In July 2001, the government established the National AIDS Commission to coordinate the national response, provide support to implementing agencies, mobilize resources, and monitor progress under the strategy.

Malawi is expected to progressively increase its spending in the fight against HIV/AIDS. Additional financing is expected from its proposals on the fast-track access under the Global Fund to Fight AIDS, Tuberculosis and Malaria (amounting to US$284 million, including US$20 million for the first year). These proposals, however, are still under consideration and have been classified as needing more adjustments or clarification.

[1] Markus Haacker , "The Economic Consequences of HIV/AIDS in Southern Africa," IMF Working Paper 02/38 (Washington: IMF 2002).

24. **There are, however, risks that could derail the authorities' strategy:**

- A lack of spending discipline by the government could result in the reemergence of excessive government borrowing and, therefore, add further pressure to real interest rates. Also, exogenous shocks—such as adverse weather and movements in commodity prices—could complicate macroeconomic management.

- The PRSP does not clearly specify the pro-poor programs that will be protected should shocks require adjustments to the budget. This shortcoming, together with capacity constraints and the weaknesses in public expenditure management, could result in a diversion of funds into nonpriority areas.

- The generally weak implementation and absorption capacity is being exacerbated by the high rate of HIV/AIDS, which is rapidly taking its toll on both the public and private sector (Box 5). Moreover, an expected rise in the HIV/AIDS prevalence rate might require a further reallocation of resources into staff recruitment and training.

- The election cycle could also jeopardize implementation of the PRSP. In the run-up to elections in 2004, budgetary pressures could reemerge, the structural reform program could be derailed, and improvements in governance could be reversed.

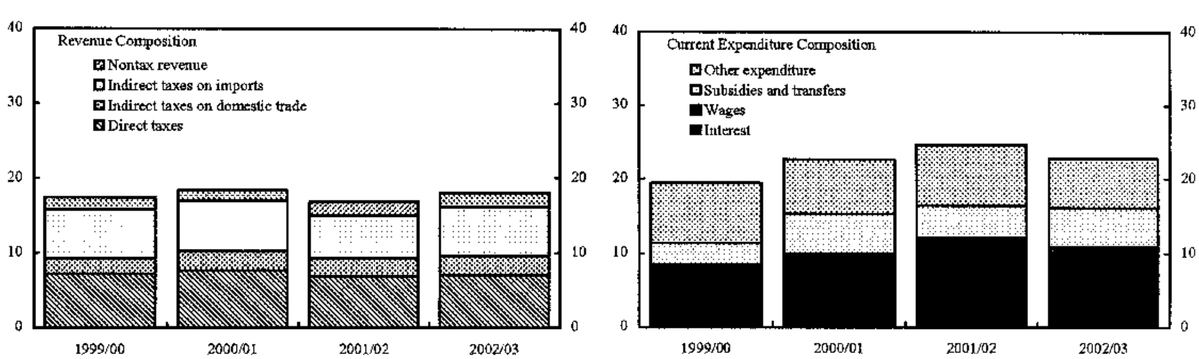
B. Macroeconomic Policies in 2002

25. **Policies in 2002 focus on restoring macroeconomic stability in the face of the impending food emergency.** Real growth is expected to pick up only moderately, to less than 2 percent, since agricultural output is expected to remain depressed and the recovery in the manufacturing and service sectors will only be gradual. Inflation is targeted to decline to 5 percent by end-2002. The external current account deficit (before grants) is projected to widen sharply in 2002, in response to large-scale food imports.

Fiscal policy

26. **As expansionary fiscal policies continued to derail the macroeconomic strategy, the discussions in 2001-02 focused on the need to address the repeated expenditure**

Figure 8. Revenue and Expenditure Composition, 1999/2000-2002/03, (In percent of GDP)



slippages by trimming nonpriority spending and limiting the drain on the budget from parastatals while translating the PRSP priorities into the budget (Figure 8). These actions were to be accompanied by measures to strengthen expenditure control. In light of the already weak private sector, the strategy relied only to a limited extent on raising additional revenue.

2001/02 budget

27. **To reverse the expansion in the 2000/01 budget while reorienting spending toward pro-poor areas, the 2001/02 budget was to incorporate decisive cuts in nonpriority spending.**

- However, the 2001/02 budget submitted and approved by parliament was about 3 percent of GDP more expansionary than agreed because of larger spending and tax cuts. The authorities argued that these would be offset by a substantial increase in fees and charges and a strong supply response from the lighter tax burden. The staff stressed that new mechanisms to raise nontax revenue were unlikely to become fully effective immediately, and that reliance on unproven cost recovery measures appeared risky. Moreover, some of the contemplated increases in fees appeared to have a negative social impact.[16] The staff also cautioned against expecting major revenue increases from tax cuts and emphasized that the reduction in income tax rates was regressive—benefiting less than 5 percent of the population—and inconsistent with the pro-poor strategy of the program.

- It quickly became clear that the domestic deficit would exceed program targets, as the envisaged increase in tax and nontax revenue did not materialize, the government financed another bailout of ADMARC, and import-related tax revenue weakened. In December 2001, efforts to take corrective action failed when fiscal measures of 2 percent of GDP, mostly on the expenditure side, were not implemented.[17] Instead, the cabinet approved increases in recurrent expenditure[18] and extended civil servants' housing allowances.

28. **Although expenditure appears to have been contained since March 2002, the domestic deficit for 2001/02 is estimated to exceed 8 percent of GDP—3½ percent of GDP more expansionary than in 2000/01.**[19] When the cabinet finally approved expenditure

[16] Such as increases in fees for attending technical and nursing schools.

[17] These measures had focused on containing overruns in those categories that had already marred the implementation of the 2000/01 budget (see footnote 5).

[18] The largest increases were for external affairs, defense, and transfers to statutory organizations.

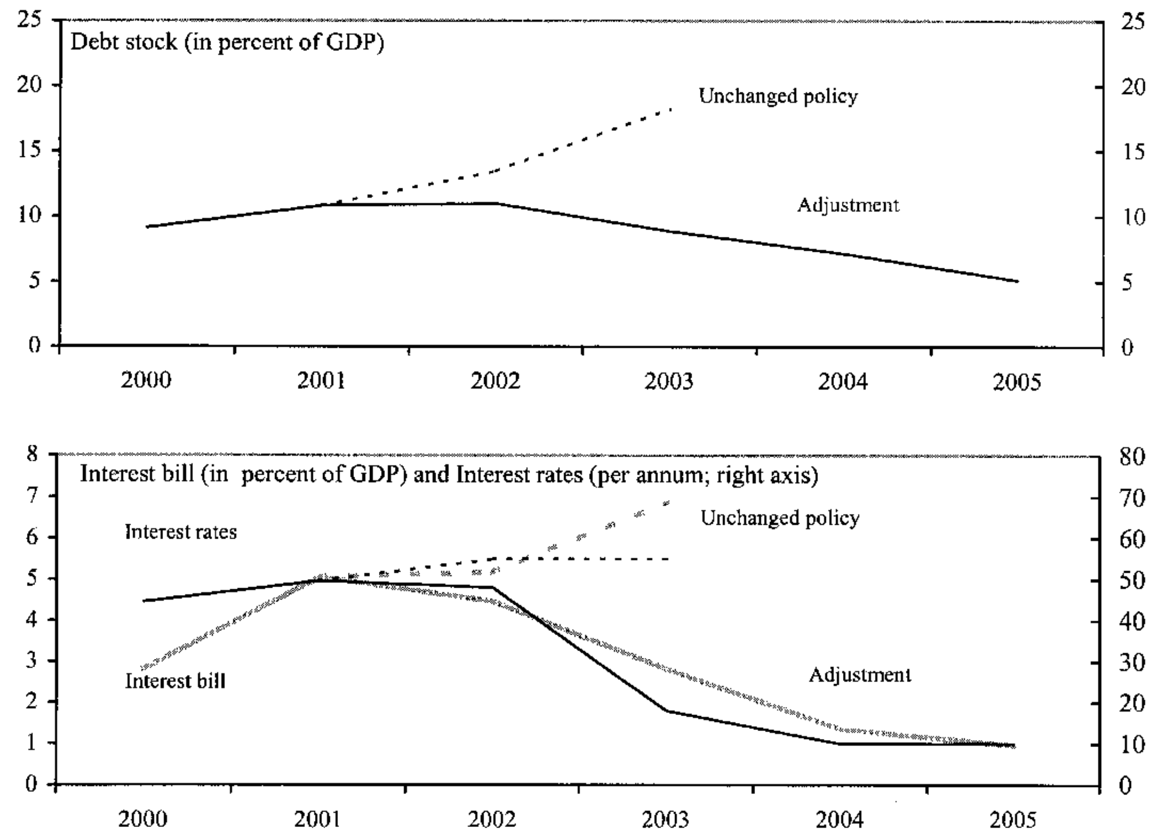
[19] The overrun would have been larger if the government had not reduced its interest bill by shifting some of the interest cost to the RBM. According to the Reserve Bank Act, the government has to cover the RBM's operational loss in 2001. However, neither an estimate of the loss is yet available nor is it clear when the government will take over the loss; therefore, the estimate for the domestic balance does not include this transaction.

cuts of 3½ percent of GDP in February 2002, the staff stressed that the size of the cuts was completely unrealistic, since it would have implied no funding except for wages for one in four ministries and less than half the monthly funding for two-thirds of the ministries; moreover, cuts in pro-poor spending would have been debilitating. Thus, agreement was reached to contain expenditure during the remainder of the fiscal year, implying cuts of about 1¼ percent of GDP during April-June 2002 from the budget amended by the cabinet in December 2001. Notwithstanding, pro-poor spending on priorities identified in the PRSP was increased by 1¾ percent of GDP from 2000/01 (Table 7).[20]

2002/03 budget

29. **Minister of Finance Jumbe took office in January 2002 and publicly acknowledged that a decisive turnaround in fiscal policy was needed to establish macroeconomic stability, halt the increase in public debt, and create an environment conducive to private sector-led growth.** While previously the focus had been on large fiscal

Figure 9. Policy Impact on Domestic Debt Stock, Interest Bill, and Interest Rates, 2000-2005



[20] Additional pro-poor spending was mostly allocated to health and education; it also included the introduction of professional allowances for medical personnel and teachers. During July 2001-March 2002, the

(continued)

deficits crowding out private sector investment, debt sustainability has now become an issue as well. Owing to a prolonged period of expansionary fiscal policies, Malawi's domestic debt (consolidated between the central government and the RBM) increased rapidly, rising to 11 percent of GDP at end-2001, and would increase further, by 7 percent of GDP, by end-2003 under unchanged policies (Figure 9). With a decisive adjustment, however, domestic debt could be stabilized in 2002 and reduced from 2003 onward. The authorities agreed with the staff's assessment.

30. **Thus, the government has submitted to parliament a 2002/03 budget envisaging strong adjustment by reducing the domestic deficit to 5½ percent of GDP (memorandum of the economic policies (MEP) paragraph 7).**[21] While the size of this adjustment is ambitious, it has to be viewed in the context of the need to reverse the expansion in the two preceding fiscal years and to arrest an unsustainable domestic debt situation:

- **Some of the adjustment will come from savings on the interest bill (about 1 percent of GDP),** predicated on a rapid decline in interest rates following the fiscal adjustment. This would be comparable to the impact of the adjustment undertaken in 1996/97. Given the short average duration of the debt stock, interest savings should be quickly reflected in the budget.

- **Tax measures are expected to boost revenue by 1¼ percent of GDP (MEP paragraph 9).** Rates of the personal income tax, and excises on alcohol and cars have been increased, thereby reversing some of the tax cuts introduced in July 2001. Moreover, the authorities will extend the surtax to the retail level.[22] Both the staff and the authorities felt that a reversal in the corporate tax rate cut of July 2001 was not warranted, as private sector activity was depressed.[23] The authorities emphasized that tax policy measures would be complemented by further efficiency gains in the operations of the Malawi Revenue Authority (MRA).

- **The remaining fiscal adjustment will come from cuts in nonpriority expenditure of 2¼ percent of GDP (MEP paragraph 8).**

- **At the same time, however, pro-poor spending will be increased by 1¾ percent of GDP.** Pro-poor spending on priority areas will be further increased by ¾ of 1 percent of GDP. Moreover, a general price subsidy on maize of about 1 percent of GDP will

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implementation of the pro-poor spending was mostly on track, although some individual categories showed spending below target.

[21] All references are to the memorandum on the economic policies (MEP; Appendix I, Attachment I).

[22] The surtax extension was approved by parliament in November 2001 and will become effective on September 1, 2002.

[23] However, the new top rate will create a 10 percentage point gap between the top personal income tax rate and the corporate tax rate on retained earnings, which could give rise to increased tax evasion (see Selected Issues and Statistical Appendix, forthcoming).

be provided to make maize affordable for the poor who do not benefit from humanitarian aid programs (see paragraph 37).[24]

Wage policy

31. **Recognizing that high attrition rates and low wage competitiveness are adversely affecting the performance of the civil service, the authorities are developing a medium-term wage policy (MEP paragraph 13).** The staff encouraged the authorities during the discussions on the 2001/02 budget to provide wage increases to teachers and health workers, for whom wages are the least competitive and attrition rates the highest, and a cost of living adjustment for all other civil servants. It stressed that general ad hoc changes to remuneration were undesirable in the absence of broader reforms. The authorities, however, indicated that they were under severe pressure from civil servants for a higher pay raise, and they approved several changes to the remuneration policy over the year, including an extension of the full housing allowance to all civil servants at the beginning of 2002. This extension, together with other pay raises, increased the overall wage bill by almost 2 percent of GDP since 1999/2000, to 6.4 percent of GDP in 2001/02. The staff urged the authorities to refrain from further ad hoc increases in the wage structure and to accelerate the formulation of a new wage policy that improved internal and external pay relativities—a reform that was originally expected to have been introduced with the implementation of the 2002/03 budget.

Parastatals

32. **Accelerating parastatal reform is key to restoring budget discipline (paragraph 14).** To establish hard budget constraints for parastatals, the authorities stressed that they would, as a first step, enhance transparency by clearly distinguishing core parastatal activities from government policies and bringing the latter explicitly on budget. This move will be supported by the PERMU's monitoring and eventually controlling the financial operations of parastatals, such as through the approval of any parastatal borrowing.[25] In parallel, the authorities will improve the efficiency of parastatals through a strategy of commercializing, liquidating and privatizing.[26] The staff welcomed this renewed commitment but noted that the reforms were overdue.

Expenditure control

33. **Lingering weaknesses in implementing the new expenditure control systems have continued and need to be addressed forcefully (MEP paragraph 10).** While the basic systems to monitor commitments, cash expenditure, and arrears are in place, start-up

[24] The subsidy has been estimated based on projected landing, distribution and financing unit costs minus the end-consumer price of maize.

[25] The government is not extending any new guarantees for parastatal borrowing, with the exception of borrowing by the NFRA in relation to the 2002/03 food shortage.

[26] Large parts of the economy remain dominated not only by parastatals, but also by one semiprivate conglomerate, the Press Corporation.

problems have become persistent, as there are few incentives, in particular for controlling officers, to strengthen expenditure management. Implementation problems have been affecting both the quality and the timeliness of the reports, which, in turn, might have discouraged decision makers from utilizing them. The staff urged the authorities to put in place an improved credit ceiling authority (CCA) system for the 2002/03 budget. Malawi has completed a fiscal ROSC (Box 6 and Selected Issues and Statistical Appendix, forthcoming).

Box 6. Report on the Observance of Standards and Codes (ROSC)

An assessment of fiscal transparency practices in Malawi in relation to the requirements of the IMF Code of Good Practices on Fiscal Transparency has been issued to the Board concurrently with this staff report.

The ROSC notes a number of significant improvements to budget management in recent years, including the development of a sophisticated classification system and the introduction of the medium-term expenditure framework (MTEF) budgeting process. However, the developments have not been applied consistently across the different areas of fiscal management, and attention to data quality has been insufficient. Further work is needed to improve the reporting of fiscal information to parliament; the legislative environment; the quality of fiscal data; the budget preparation process; the financial management of the privatization process; and the transparency of the district, town, city, and municipal assembly activities.

34. **The introduction of a monitoring system for pro-poor spending with the 2002/03 budget will increase the accountability of government (MEP paragraph 11).** The staff reiterated that the tracking of pro-poor spending was key for a successful implementation of the PRSP (Table 8). The authorities stressed that improved transparency would increase discipline and be necessary for accountability. Moreover, the Minister of Finance has publicly expressed his strong support for making fiscal data available to the public.

35. **While it appears that the stock of domestic expenditure arrears has increased only moderately, doubts remain regarding the veracity of the data (MEP paragraph 13).** Coordination among government agencies remains weak, and reconciliation of various sources has been slow. As a result, reporting remains scattered and delayed, and arrears are usually not cleared in a timely manner. The staff urged the authorities to use the timely audit of arrears at end-June 2002 for cleaning the slate, and to ensure that strengthened procedures would be in place from then onward.

Food security

36. **Humanitarian aid pledges by donors will broadly cover the import requirement identified by the FAO/WFP for the most vulnerable in society for August 2002-March 2003.** The aid will be distributed through nongovernmental organizations (NGOs) and social safety net programs.

37. **In addition, the government—through the NFRA—will undertake large-scale imports of maize, which it will provide at a subsidized price during 2002/03 (MEP paragraph 5):**

- **The government plans to import up to 250,000 metric tons to meet the commercial import requirement projected by the FAO/WFP.** The government concluded that operations of this size could not be reliably undertaken by the private sector, owing to credit and logistical constraints, and that it needed to take decisive action early, given the downside risks of late arriving imports as experienced earlier this year.[27] Given the humanitarian risks involved, the staff endorses the authorities' decision to import maize. However, the staff encourages the authorities to explore ways to involve the private sector in particular in the importation but also the distribution of maize.

- **As the authorities are concerned that a large part of the population would be unable to afford maize at import cost, they intend to subsidize maize sales.** In addition to the 30 percent of the population of the ultra-poor that will benefit from free food aid, the authorities concluded that another 35 percent of the population (the remainder of those classified as poor) did not have sufficient purchasing power to buy maize at import parity prices, as their ability to cope had been eroded after the recent food crisis when many sold assets, including livestock, to purchase food. While the authorities did consider making the subsidy available through targeted transfers to minimize the risk of market distortions and reduce the cost to the budget, they concluded that no effective targeting mechanism was available or could be established quickly.[28] Thus, a price subsidy was seen as the most efficient channel of providing such a transfer. This conclusion has been endorsed by the civil society and corroborated by a World Bank analysis that concluded that over half of the total subsidy would accrue to the target group.[29] The authorities stressed that the price for maize would be set at a level so as not to discourage local maize production,[30] and the subsidy would be transparently assumed by the budget. The program's deficit target has been raised to accommodate the costs of the subsidy (see paragraph 30).

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[27] Small-scale private sector imports, in particular from northern Mozambique which according to the FAO/WFP has a maize surplus of 100,000 metric tons, are expected to complement this operation. Maize imports from Mozambique over the last season have been estimated at 40,000 metric tons.

[28] In particular, no targeting mechanisms exist for the urban poor. While targeting schemes for the rural poor exist in principle, their effectiveness has been low (de facto the targeting is at the discretion of the village chief), as shown by the targeted input program for smallholder farmers.

[29] In addition, the ultra-poor, who will receive free food covering 75 percent of their consumption, will also benefit, capturing another 10 percent of the total subsidy.

[30] The government intends to sell the maize at MK 17.5 per kilogram, compared with the costs of about MK 25; in May 2002, market prices ranged from MK 9 to MK 13. In real terms, the price will be set at a level which is considerably higher than the average over the past 5 years. The World Bank confirmed that there will be little negative impact on production, given the current cost structure.

38. **The staff suggested that the authorities quickly establish a dialogue with donors and agree on a joint, comprehensive strategy covering all food security operations to be undertaken in 2002/03.** Moreover, as maize operations by government have given rise to governance issues in the past, the staff stressed that all elements of the food security operation should be set out transparently, clearly communicated to the public, and carefully monitored and controlled, including through civil society participation.

39. **The staff is encouraged that the authorities are in the process, together with donors, of reviewing their national food security operations[31] and are revamping their agricultural policies**. As food security is at the heart of improving the living standards of the poor, the staff expressed disappointment that this area had not received sufficient attention in the past. The staff welcomed the authorities' intention to review the operations of the NFRA and ADMARC in 2000-01 by external audit and to move the responsibility for compiling agricultural production statistics to the National Statistics Office from the Ministry of Agriculture.

Monetary policy

40. **Money will remain the nominal anchor in the disinflation effort (MEP paragraph 16).** The authorities, consistent with the PRSP, are maintaining their inflation target of 5 percent for end-2002,[32] and, to this end, the RBM is targeting a growth in money supply (M3) of 8 percent, down from 12 percent in 2001. It will continue to use reserve money as the operational target, and its growth will be contained at 7 percent during 2002.[33] This will provide room for a substantial increase in private sector credit in real terms to compensate for the reduction during 2001. However, the staff cautioned the RBM to carefully monitor the recent pickup in inflation and stand ready to tighten the monetary stance, if necessary.

41. **The RBM stressed that the exchange rate would continue to be market determined; its intervention in the foreign exchange market would be limited to meeting the gross international reserves target and moderating short–term fluctuations,**

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[31] In particular, criteria for declaring a food security situation need to be identified, and the responsibilities of the NFRA, the Ministry of Agriculture and the Ministry of Finance and Economic Planning in the decision-making and implementation process need to be delineated.

[32] Achieving this inflation target will require only a slight decline in the underlying inflation rate. The 12-month rate currently reflects the sharp increase in maize prices during July-October 2001 and, with maize prices not expected to exceed 2001 peak levels, 12-month inflation is projected to decline towards the underlying rate. Moreover, the maize price subsidy will have a deflationary impact, offsetting the impact of the extension of the surtax, which is estimated to add 2 percentage points to the headline inflation rate in September 2002.

[33] The RBM has refined its monetary instruments with technical assistance from the Fund. Measures have included an adjustment in treasury bill and RBM bill tenors and auction dates, as well as an improved framework for forecasting government revenue and expenditure, jointly developed with the Ministry of Finance and Economic Planning. Moreover, the RBM has opened up to new participants the market for RBM bills; it has also delinked the rate on the violation of reserve requirements from the bank rate and converted it into a real penalty rate.

without attempting to influence underlying market trends (MEP paragraph 17). The RBM agreed with the staff's assessment that the level of the real exchange rate was broadly appropriate and that some real depreciation of the kwacha might result from the fiscal adjustment. However, especially during 2001, it has been smoothing seasonal movements in the nominal exchange rate,[34] as these movements could have an adverse distributional impact on smallholder farmers.[35] While the staff shared the RBM's concern about the distributional impact, it emphasized that it was difficult to distinguish seasonal from fundamental movements. Thus, the staff suggested that the surrender requirement be further reduced and encouraged market participants to develop appropriate instruments for smallholders to hedge against these risks.

42. **The financial sector has been under some strain but remains sound (MEP paragraph 18).** Banks remain well capitalized and the average risk-weighted capital ratio of the banking system increased to 34 percent in March 2002 from 23 percent in December 2000. However, nonperforming loans, comprising about 12 percent of total loans in the system in December 2001, remain an issue for some banks and financial institutions, albeit they have not increased since the beginning of 2001. The staff welcomed the privatization of the Commercial Bank of Malawi as a step in the right direction and away from the oligopolistic structure of the market. It also urged the authorities to develop the legal and regulatory basis for microfinance—one of the PRSP priorities—in the context of the review of the financial sector regulatory framework.

External sector

43. **Reflecting the large food imports in 2002, the external current account deficit is expected to widen to 26 percent of GDP, financed by humanitarian assistance, concessional loans, and a drawing down of international reserves.** Export receipts are projected to increase by 3½ percent in U.S. dollar terms, mostly as a result of a price-induced growth in tobacco exports. Tea, sugar, coffee, and nontraditional exports are expected to rise moderately after their strong performance in 2001. In addition to large-scale maize imports, nonmaize imports are forecast to rebound strongly in 2002, owing to pent-up import demand. The projected current account deficit will be financed largely by humanitarian aid related to food imports, concessional loans from the World Bank and the African Development Bank, and a decline in international reserves. International reserves will drop to less than

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[34] In 2001, the RBM reduced the surrender requirement to 40 percent of all export receipts from 60 percent and temporarily increased the foreign exchange exposure limit of banks to 45 percent of core capital from 35 percent. Moreover, it allowed banks to hold U.S. dollar-denominated deposits at the RBM (so-called FEX-CODs). The FEX-CODs are certificates of deposit denominated in U.S. dollars, with tenors between 7 and 90 days at the London interbank offered rate (LIBOR) minus 150 basis points. FEX-CODs are excluded from the calculation of foreign exposure limits.

[35] Farmers suffered in particular from the two large devaluations after the tobacco seasons in 1998 and 2000. As a large share of export earnings has to be surrendered and converted into the domestic currency, no hedging opportunities are available for smallholders and farmers are credit constrained, devaluations after the growing seasons impact on their income and their ability to purchase inputs for the coming season.

1½ months of imports in November—a level which would be inadequate on an ongoing basis—and would recover to about 2 months at end-2002 after being replenished by donors in December, if the program is on track.

44. **The staff commended Malawi for making notable progress in liberalizing its trade regime.**[36, 37] The unweighted average tariffs have declined to 13.6 percent in 2001 from 15.8 percent at end-1998. The trade regime has six tariff bands, with a maximum rate of 25 percent and no significant nontariff barriers. Import licenses have been removed, except for some temporary ones (see the following paragraph), and those maintained for health, safety, security, and environmental reasons. As a member of the Southern African Development Community (SADC) and the Community of Eastern and Southern African States (COMESA), Malawi is actively pursuing regional integration. In addition, Malawi is a member of the Regional Integration Facilitation Forum (RIFF), which encourages a "fast track" to trade liberalization.[38] As overlapping membership has resulted in complexities that can impede trade and investment, staff urged the authorities to seek the rationalization of Malawi's trade agreements.

45. **The authorities have imposed temporary import restrictions (MEP paragraph 19).** In response to claims of unfair trading practices by Zimbabwe, import licenses, independent of country of origin, were introduced at end-2001 on cement and sugar, and bans were imposed on dairy products, vegetable cooking oil, and dry cells. The bans on vegetable oil and poultry have already been removed,[39] and it is expected that the remaining restrictions will cease by July 2002. The staff urged the authorities to refrain from protectionist policies and welcomed the swift removal of the restrictions.

46. **Inefficiencies in the tobacco-marketing system are adversely affecting exports and reducing the income of smallholder farmers.** The marketing system increases the cost for farmers through a variety of fees and charges[40] and through high farm-to-market transaction and logistics costs. These high costs are exacerbating the effects of reduced international tobacco prices. As a consequence, farmers are increasingly bypassing the auction system by selling directly to buyers in neighboring countries.[41] The authorities have decided to liberalize the market so that farmers will, in principle, be able to export directly without having to go through the auction system. However, they have acknowledged that the

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[36] The trade regime now has a rating of 2 on the 10 point-scale of the Fund's trade restrictiveness index.

[37] See also Selected Issues and Statistical Appendix, forthcoming.

[38] Recently, RIFF has broadened its agenda to include regional macroeconomic surveillance and investment facilitation.

[39] The poultry ban was removed in response to shortages.

[40] These include a fee of 3.95 percent of the gross revenue (compared with 2.4 percent in Zimbabwe) imposed by Auction Holdings Limited (AHL), the sole auction company; a series of institutional fees amounting to 3.58 percent of gross revenue; and a 7 percent withholding tax (which can be credited against the final tax assessment for resident taxpayers) on revenue obtained from auction sales.

[41] Given the absence of processing facilities in these countries, the tobacco is then reimported into Malawi for processing, but it is not subject to the various fees.

new policy could have adverse implications for smaller farmers[42] and are considering a gradual liberalization, beginning possibly with the 2003 tobacco harvest. In the meantime, however, a 20 percent export duty has been implemented to avoid tax losses.[43]

Structural reforms and governance

47. **Structural reforms in 2002 will focus on privatizing large-scale utilities (MEP paragraph 14)**. As the market structure, however, will remain oligopolistic, with assets held by few market participants and, thus, characterized by complex interlocking ownerships, the staff stressed that privatization would need to be accompanied by actions to improve market information, foster entry, and create and enforce an appropriate legal and regulatory framework.

48. **The ACB has shifted its strategy toward strengthening the legal framework (MEP paragraph 15) (Box 7).** Many high-profile cases have been pending owing not only to shortcomings in the legal system, but also to understaffing and capacity constraints. Thus, the ACB has submitted to the Law Commission amendments to the Corrupt Practices Act that would raise the act to international standards. It has also focused on enhancing both its

Box 7. Governance

Efforts to improve governance are based on three key elements: strengthening accountability; improving transparency; and combating corruption. They are complementary to the PRSP and the decentralization process which are designed to increase stakeholder participation in decisions on resource allocation and policy design.

Strengthening accountability. Efforts focus on making officials answerable for their actions and decisions. The intention is to instill the notion that officials are liable to sanctions, thus making them likely to operate according to best practices. To this extent, the government is revamping the legal framework by splitting the Finance and Audit Act into two separate acts, the Public Finance Management Act and the Public Audit Act, with the aim of redefining the respective roles of officials.

Improving transparency. Making information readily and easily accessible is needed to make accountability effective. Transparency calls for an open system of public sector management, and the efforts focus on procurement and budget execution. A Procurement Act has been drafted and is expected to be submitted to parliament by end-2002. Interim procurement guidelines (IPG), extracted from the draft act, have been in use since July 2000.

Combating corruption. The Anti-Corruption Bureau (ACB), established in 1997, is empowered under the Corrupt Practices Act to investigate complaints of corrupt practices and, subject to the directions of the Director of Public Prosecutions (DPP), to prosecute. The ACB also educates people about corruption and takes measures to prevent corruption.

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[42] The authorities contend that small farmers would be disadvantaged in dealing with the three main multinational buyers once the larger and better organized farmers have found alternative market outlets.

[43] To counter tax evasion by exporters, it would have been sufficient to impose a 10 percent tax.

own capacity as well as that of magistrates. The staff reiterated that bringing to closure high-profile cases would significantly boost the credibility of the anticorruption campaign.

IV. Technical Assistance and Data Issues

49. **Malawi's capacity to generate meaningful macroeconomic data has weakened considerably in the past year (MEP paragraph 20).** Lags in compiling program statistics have lengthened, and no due diligence efforts or cross-checks are undertaken. Shortcomings are most striking in fiscal, national accounts, and trade data, but also extend to monetary data. Moreover, public dissemination of data is deficient and subject to long delays. While the staff has been dedicating considerable time to improving the data situation, it noted insufficient commitment from the authorities' side. The staff has repeatedly expressed concern about the data situation and welcomed efforts by the authorities to address the shortcomings. It strongly suggested that a program-monitoring committee be established, with the involvement of the Fund's Resident Representative.

50. **Malawi has been receiving substantial technical assistance from multilateral and bilateral donors.** However, major initiatives, such as the Integrated Financial Management System (IFMIS) and the book-entry system for government securities, have stalled for several years, reflecting in part a lack of coordination between donors and government agencies, but also the fact that competent staff members to implement these sophisticated systems are spread too thin.

51. **The RBM has made good progress in implementing the recommendations of the safeguards assessment of July 2001 (MEP paragraph 18 and Box 8).**

Box 8. Safeguards Assessment of the Reserve Bank of Malawi (RBM)

A safeguards assessment of the adequacy of the RBM's external audit mechanisms, the legal structure and independence, the financial reporting framework, the internal audit mechanism, and the internal control system (ELRIC) was completed by Fund staff in July 2001. The preliminary conclusions drawn from the assessment indicate that the RBM safeguard procedures generally appear adequate. However, the assessment also identified some vulnerabilities in the RBM's financial reporting and internal controls. The RBM has since been implementing the Fund's recommendations:

- Preparation of annual financial statements in **full compliance with International Accounting Standards (IAS)**—the RBM will be presenting the 2001 accounts in compliance with IAS.
- Adoption of a formal policy to ensure the **effective and timely implementation of all audit recommendations**—the RBM has implemented the recommendations of the management letter for 2000, which have been sanctioned by the audit committee. It is strengthening its internal audit with the help of its external auditor.
- **Reconciliation of foreign reserve balances** and strengthening of reconciliation procedures and financial reporting practices in this area—the RBM increased staff reconciling foreign exchange accounts; it is now reconciling reserve balances on a monthly basis for all accounts and on a daily basis for the most important accounts, and it is strengthening reconciliation procedures and financial reporting practices.

V. Program Monitoring

52. In order to establish a strong track record through end-September 2002 for the completion of the first review under the PRGF arrangement, the staff will monitor the implementation of the authorities' program on the basis of quarterly quantitative indicative targets for end-June 2002 and end-September 2002 and of structural benchmarks (Box 9), as described in Tables 1 and 2 of Appendix I, Attachment I, and as defined in the technical memorandum of understanding (Appendix I, Attachment II). The execution of the fiscal program will be monitored via the total financing of the central government, instead of the net domestic financing, as was specified under the original program, so as to better capture overall budgetary developments. The reserve money target will be monitored via the average daily (operational) data over the quarter instead of through the average over the last day of each month, as under the original program, in order to avoid target breaches caused by short-term liquidity management problems. The prohibition against the NFRA's borrowing has been eliminated, reflecting the agency's role in the authorities' food security operation. With regard to the monitoring of the PRSP implementation, see the forthcoming JSA.

Box 9. Structural Conditionality

Coverage of structural conditionality in the current program. The program's structural measures focus on areas that are critical for macroeconomic stability and the execution of monetary and fiscal policies. With the exception of a prior action on ADMARC's noncore assets, which have been absorbing substantial budgetary resources, conditionality has been applied only to the monitoring and control of parastatals and budget expenditure (see Table 2 in Appendix I, Attachment I).

Status of structural conditionality from earlier programs. The implementation record has been mixed (see Table 7 for the implementation status).

Structural areas covered by World Bank and African Development Bank lending and conditionality. The World Bank has lending operations in the following areas: environment, biodiversity, water, infrastructure, population, privatization, infrastructure, trade, and social safety nets. In each of these areas, it is providing technical assistance for formulating policy and strengthening institutions. The World Bank is preparing a structural adjustment operation for end-2002, focusing on public expenditure reforms and public enterprise management, which is expected to complement Fund structural conditionality. The African Development Bank is also preparing an adjustment operation that will have conditionality on governance issues and fiscal transparency.

Other relevant structural conditions not included in the current program. The World Bank has taken the lead on revamping the food security and agricultural policies, although these reforms have so far not been covered by conditionality. However, the proposed Malawi Social Action Fund (MASAF) III operation might cover at least the technical aspects of developing these policies.

VI. Staff Appraisal

53. **The most pressing need for Malawi now is to avert malnutrition and starvation.** The staff welcomes the government's efforts to address the problem, with the assistance of donor initiatives and pledges. It endorses the authorities' decision to undertake large-scale

food imports. Moreover, as targeting mechanisms are not available, the staff supports the provision of a general price subsidy as the most efficient way of reaching the poor that do not benefit from humanitarian aid. The staff urges the authorities, with the assistance of the World Bank and donors, to find ways allowing the private sector to participate in the importation and distribution of maize and, at the earliest opportunity, review and revamp their food security operations and agricultural policies, with a view to reducing the vulnerability of the poor to food shocks.

54. **Malawi has made some progress in restoring macroeconomic stability**. Inflation has declined substantially, and the inflation target for 2002 is within reach. However, expansionary fiscal policies have pushed up real interest rates to levels undermining the growth strategy.

55. **Growth remains elusive.** Restoring macroeconomic stability is not sufficient to generate growth in the medium-term. The government will need to create an enabling environment for private sector–led growth by reducing its involvement in the economy and improving the transparency and accountability of public sector operations. The staff endorses the authorities' growth strategy, which also emphasizes building human capital through better health services and education of the poor. However, the staff urges the authorities to develop a more coherent agricultural policy to ensure that the agricultural sector actually becomes the engine for medium-term growth. Moreover, the staff encourages the authorities to further analyze the impact of HIV/AIDS on their growth strategy.

56. **Monetary restraint must be sustained if continued progress is to be made in lowering inflation**. The RBM will need to adhere to its reserve money target and stand ready to tighten its stance, in response to recent inflationary pressures, if necessary.

57. **Malawi's exchange rate regime remains appropriate and the exchange rate competitive.** In this respect, the staff is encouraged that the RBM has limited its interventions to smoothing short-term fluctuations and meeting its gross international reserves target. Official reserve developments over the next months should be monitored carefully.

58. **The staff welcomes that fiscal policy has been tightened substantially with the 2002/03 budget.** Without decisive adjustment, the domestic debt would quickly become unsustainable. High-level political commitment is required to implement the fiscal program successfully, and, in particular, to contain expenditure and stay within the fiscal envelope provided by the budget. In this respect, the staff urges the authorities to postpone low-priority projects, including the various housing construction programs.

59. **Parastatal operations will need to become more transparent.** Government mandates will have to be clearly distinguished from the commercial activities of parastatals, and subsidies will have to be budgeted. This process will ensure that policymakers factor in the competing demands for budget resources. While the privatization agenda should be completed expeditiously, it is critical to make markets more competitive.

60. **The staff welcomes the reorientation of expenditure toward pro-poor programs identified in the PRSP.** It is encouraged by the authorities' strong commitment to track, monitor, and publish the execution of pro-poor expenditure.

61. **More work, however, is necessary to make the expenditure system an effective tool of fiscal control.** Given the large overruns in nonpriority expenditure in the past, it will be essential to closely monitor and control the execution of the budget. In particular, the authorities will need to enhance the discipline of controlling officers by holding them accountable for meeting budgetary targets.

62. **The staff is encouraged that the legislative framework for addressing corruption is being strengthened and the capacity of the investigative authorities and the judiciary built up.** However, the credibility of Malawi's anticorruption campaign would be greatly enhanced by bringing to closure high-profile cases.

63. **Malawi's economic and financial statistics have suffered from long-standing deficiencies and deteriorated in recent years.** Moreover, data provisions to the Fund and public dissemination of data is deficient and subject to long delays. The staff, therefore, urges the authorities to address these problems decisively, since they are undermining the effective formulation and implementation of policies. A sustained effort is needed to make lasting progress in improving the quality of the data.

64. **While the authorities are committed to implementing the economic program and, in particular, to attaining macroeconomic stability, there are risks that could derail their strategy.** First, successful fiscal adjustment hinges critically on a demonstration of commitment from the highest political level and discipline by controlling officers—both of which might be jeopardized in the run–up to the presidential elections in 2004. Second, while the monitoring of parastatals has been improved considerably, further pressures for the budget might emerge from their operations. Finally, following many years of stop-and-go policies, inflation expectations may persist and real interest rates remain high, with adverse consequences for the budget and growth.

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

Table 1. Malawi: Selected Economic and Financial Indicators, 2000-05

	2000		2001			2002		2003	2004	2005
	EBS/00/263	Est.	EBS/00/263	EBS/01/90	Prel.	EBS/01/90	Proj.		Proj.	
	(Percentage change, unless otherwise indicated)									
GDP and prices										
GDP at constant market prices	3.2	1.7	3.0	2.7	-1.5	4.0	1.8	4.5	5.2	5.4
Consumer prices (end of period)	30.0	35.4	10.0	10.0	22.1	5.0	5.0	5.0	4.2	4.1
Consumer prices (annual average)	28.5	29.6	20.0	20.2	27.2	7.5	9.4	5.0	4.4	4.2
GDP deflator	25.5	25.2	16.8	21.1	26.1	7.3	12.2	4.7	4.1	4.6
Interest rates (end of period) 1/	...	86.6	...	...	54.6	...	...	...	...	...
Nominal effective exchange rate (end period) 2/	...	-32.0	...	...	38.8	...	...	...	...	...
Real effective exchange rate (end period) 2/	...	-15.6	...	...	52.2	...	...	...	...	...
External sector										
Exports, f.o.b. (millions of U.S. dollars)	431.0	405.5	438.0	442.3	406.8	474.5	421.1	451.2	481.3	513.5
Imports, c.i.f. (millions of U.S. dollars)	625.0	563.2	614.4	580.6	582.2	659.2	768.2	657.2	693.3	731.4
Terms of trade	-6.1	-6.2	2.2	15.1	0.7	5.2	5.9	1.8	1.4	1.3
Money and credit 3/										
Money and quasi money	20.9	42.4	16.8	14.0	12.1	11.1	7.9	13.4	13.5	13.4
Net foreign assets	31.1	46.8	47.0	29.7	-15.1	20.3	-17.5	41.8	27.1	21.7
Net domestic assets	-10.2	-4.4	-30.2	-15.7	27.2	-9.2	25.3	-28.4	-13.6	-8.3
Credit to the government	2.7	6.9	-43.3	-26.0	33.7	-13.3	12.1	-34.4	-29.9	-27.2
Credit to the rest of the economy	16.3	12.4	19.5	3.1	-5.1	6.2	27.6	-2.5	10.5	9.5
	(Percent of GDP, unless otherwise indicated)									
Central government 4/										
Revenue (excluding grants)	19.0	18.3	19.0	18.2	16.8	18.2	18.0	17.8	17.7	17.7
Expenditure	30.4	33.3	27.3	31.8	32.7	28.0	31.4	28.5	27.2	26.1
Domestic primary balance (cash mod. basis) 5/ 6/	1.4	-1.7	-0.3	-1.8	-3.7	-1.2	-2.2	-2.3	-1.7	-1.1
Domestic balance (cash mod. basis) 6/	-1.3	-4.7	-1.2	-5.0	-8.1	-2.9	-5.4	-3.2	-2.6	-2.0
Overall balance (cash mod. basis, including grants)	0.0	-5.8	0.0	-1.9	-8.9	1.1	-2.7	-0.1	1.2	1.9
Domestic saving	2.3	0.5	2.2	0.8	-1.0	1.4	-15.9	0.7	2.4	3.1
National saving	...	7.3	...	8.7	3.6	9.4	-2.3	7.2	9.7	10.6
Foreign saving 7/	15.2	13.9	15.4	13.2	12.9	14.9	26.2	14.4	13.8	13.3
Gross investment	15.8	12.5	16.0	12.9	10.9	15.3	9.0	13.9	15.4	15.8
Public	11.1	10.0	9.8	8.2	8.1	6.7	8.0	9.6	8.9	8.2
Private	2.7	2.6	4.2	2.5	2.8	6.4	1.0	4.4	6.5	7.6
Stock building	2.0	0.0	2.0	2.2	0.0	2.2	0.0	0.0	0.0	0.0
External sector										
Exports, f.o.b.	24.9	23.8	28.0	27.4	23.3	25.7	22.2	23.1	22.9	22.4
Imports, c.i.f.	36.1	33.0	39.3	35.9	33.3	35.7	40.5	33.6	32.9	31.9
External current account (including official transfers)	-7.8	-5.3	-6.7	-4.2	-7.3	-6.0	-11.3	-6.7	-5.7	-5.3
External debt	156.5	156.7	180.4	162.1	156.4	143.2	147.6	147.6	139.6	130.5
Debt-service ratio 8/	20.6	21.8	20.0	19.9	21.1	18.6	20.4	20.7	21.0	20.1
Of which: interest payments 8/	6.6	6.9	6.3	6.2	6.6	5.7	6.2	5.8	5.4	5.0
	(In millions of U.S. dollars, unless otherwise indicated)									
Gross official reserves										
End-period stock	224.0	242.5	276.1	304.0	201.8	350.7	129.9	228.4	278.8	319.5
In months of imports of goods and nonfactor services 9/	3.9	4.4	4.7	4.8	2.8	5.3	2.1	3.4	3.9	4.3
External debt (disbursed and outstanding, end of period)	2,706	2,674	2,824	2,620	2,736	2,642	2,803	2,883	2,939	2,992
Memorandum items:										
GDP (in millions of kwacha)	103,424	101,634	124,423	125,623	126,266	140,153	144,175	157,783	172,768	190,462
Kwacha per U.S. dollar exchange rate (per. avg.)	...	59.5	...	...	72.2	...	...	...	...	...
Per capita GDP (U.S. dollars)	...	165.5	...	...	166.2	...	...	...	...	...
Population (millions)	11.3	10.3	11.7	10.5	10.5	10.7	10.7	11.0	11.2	11.4

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

1/ Compounded three-month interest bill.

2/ Positive value denotes appreciation of kwacha.

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

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

5/ The domestic primary balance excludes grants, domestic and foreign interest, and foreign-financed development expenditure.

6/ Cash-modified basis defined as cash spending and expenditure in arrears.

7/ External current account, excluding official transfers.

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

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

Table 2. Malawi: Central Government Operations, 2000/01-2003/04 1/

	2000/01		2001/02			2002/03		2003/04
	Prog. EBS/00/263	Annual Act.	Prog. EBS/00/263	Prog. EBS/01/90	Revised Proj.	Prog. EBS/01/90	Revised Proj.	Annual Proj.
				(In millions of kwacha)				
Total revenue and grants	34,576	31,233	35,981	39,721	32,093	42,490	43,153	47,043
Revenue	21,601	20,880	24,990	24,139	22,663	26,653	27,144	29,413
Tax revenue	19,703	19,285	22,856	22,344	20,168	24,549	24,259	26,600
Taxes on income and profits	8,093	8,740	9,361	10,001	9,338	10,900	10,584	11,625
Taxes on goods and services	8,864	8,169	10,421	9,406	8,722	10,465	11,077	12,188
Taxes on international trade	3,236	2,385	3,600	2,794	2,396	3,027	2,928	3,149
Other (incl. refunds)	-491	-10	-525	143	-287	157	-330	-363
Nontax revenue	1,898	1,595	2,134	1,794	2,495	2,104	2,885	2,814
Departmental receipts	1,088	1,036	1,202	1,139	1,202	1,335	1,330	1,461
Petroleum levy for national roads authority (NRA)	780	559	902	656	1,180	769	1,232	1,353
Petroleum levy for safety nets	0	0	0	0	113	0	324	0
Transfer of RBM profits	30	0	30	0	0	0	0	0
Grants	12,976	10,353	10,991	15,582	9,429	15,836	16,009	17,630
Program	7,350	6,209	4,606	7,045	2,375	7,712	9,042	8,343
Project	4,081	3,565	2,918	3,821	3,668	3,827	3,558	3,569
HIPC	1,152	579	2,653	4,716	3,386	4,298	3,409	5,718
Total expenditure and net lending	34,602	37,887	35,935	42,273	44,143	40,912	47,286	47,274
Total expenditure	34,602	37,303	35,935	42,273	44,143	40,912	47,286	47,274
Current expenditure	22,550	25,772	25,423	29,933	33,157	30,165	34,847	33,825
Wages and salaries	6,066	5,954	7,016	7,795	8,687	8,575	9,283	10,196
Interest payments	5,137	5,267	3,091	6,571	7,644	4,611	7,046	3,915
Domestic	3,100	3,426	1,130	4,199	5,878	2,386	4,870	1,573
Foreign	2,037	1,841	1,961	2,372	1,766	2,225	2,177	2,343
Other current expenditure	10,887	13,869	12,662	14,059	16,709	16,979	18,517	19,713
Of which: maize subsidy	0	0	0	0	0	0	1,673	0
Expenditure in arrears	0	616	0	0	118	0	0	0
Development expenditure	12,052	11,530	10,512	12,340	10,986	10,747	12,439	13,450
Part I (foreign financed)	9,452	9,789	7,442	9,130	8,806	7,823	9,853	10,137
Part II (domestically financed)	2,600	1,741	3,070	3,210	2,180	2,924	2,586	3,313
Net lending	0	584	0	0	0	0	0	0
Overall balance (including grants)	-26	-6,654	46	-2,553	-12,050	1,577	-4,132	-231
Total financing	26	6,981	-46	2,553	10,878	-1,577	4,132	231
Foreign (net)	5,308	5,580	3,323	4,371	1,019	1,396	9,744	5,507
Balance of payments gap	0	0	0	0	0	0	4,824	
Borrowing	10,275	10,456	7,582	9,385	5,138	6,155	9,881	11,008
Program	4,903	4,521	3,057	4,076	0	2,158	3,587	4,440
Project	5,371	5,936	4,524	5,309	5,138	3,996	6,295	6,568
Amortization	-4,088	-5,129	-4,109	-4,386	-3,799	-4,758	-4,771	-5,501
Special loans (net)	-879	253	-150	-628	-320	0	-191	0
Domestic (net)	-5,282	1,401	-3,369	-1,818	9,859	-2,974	-5,611	-5,276
Banking system	-2,584	-201	-3,527	-2,608	10,981	-3,174	-5,818	-5,576
Nonbanks	-2,409	1,083	-42	590	-1,075	0	0	0
Domestic supplier credits (net)	0	573	0	0	-277	0	-196	101
Change in arrears	-389	-168	0	0	70	0	0	0
Privatization proceeds	100	114	200	200	158	200	403	200
Discrepancy	0	327	0	0	-1,173	0	0	0

Table 2. Malawi: Central Government Operations, 2000/01-2003/04 1/

	2000/01		2001/02			2002/03		2003/04
	Prog. EBS/00/263	Annual Act.	Prog. EBS/00/263	Prog. EBS/01/90	Revised Proj.	Prog. EBS/01/90	Revised Proj.	Annual Proj.
	(In percent of GDP, unless otherwise indicated)							
Total revenue and grants	30.4	27.4	27.3	29.9	23.8	29.1	28.6	28.4
Revenue	19.0	18.3	19.0	18.2	16.8	18.2	18.0	17.8
Tax revenue	17.3	16.9	17.3	16.8	14.9	16.8	16.1	16.1
Taxes on income and profits	7.1	7.7	7.1	7.5	6.9	7.5	7.0	7.0
Taxes on goods and services	7.8	7.2	7.9	7.1	6.5	7.2	7.3	7.4
Taxes on international trade	2.8	2.1	2.7	2.1	1.8	2.1	1.9	1.9
Other (incl. refunds)	-0.4	0.0	-0.4	0.1	-0.2	0.1	-0.2	-0.2
Nontax revenue	1.7	1.4	1.6	1.4	1.8	1.4	1.9	1.7
Grants	11.4	9.1	8.3	11.7	7.0	10.8	10.6	10.6
Program	6.5	5.5	3.5	5.3	1.8	5.3	6.0	5.0
Project	3.6	3.1	2.2	2.9	2.7	2.6	2.4	2.2
HIPC	1.0	0.5	2.0	3.5	2.5	2.9	2.3	3.5
Total expenditure and net lending	30.4	33.3	27.3	31.8	32.7	28.0	31.4	28.5
Total expenditure	30.4	32.8	27.3	31.8	32.7	28.0	31.4	28.5
Current expenditure	19.8	22.6	19.3	22.5	24.6	20.6	23.1	20.4
Wages and salaries	5.3	5.2	5.3	5.9	6.4	5.9	6.2	6.2
Interest payments	4.5	4.6	2.3	4.9	5.7	3.2	4.7	2.4
Domestic	2.7	3.0	0.9	3.2	4.4	1.6	3.2	0.9
Foreign	1.8	1.6	1.5	1.8	1.3	1.5	1.4	1.4
Other current expenditure	9.6	12.2	9.6	10.6	12.4	11.6	12.3	11.9
Of which: maize subsidy	0.0	0.0	0.0	0.0	0.0	0.0	1.1	0.0
Expenditure in arrears	0.0	0.5	0.0	0.0	0.1	0.0	0.0	0.0
Development expenditure	10.6	10.1	8.0	9.3	8.1	7.4	8.2	8.1
Part I (foreign financed)	8.3	8.6	5.6	6.9	6.5	5.4	6.5	6.1
Part II (domestically financed)	2.3	1.5	2.3	2.4	1.6	2.0	1.7	2.0
Net lending	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	0.0	-5.8	0.0	-1.9	-8.9	1.1	-2.7	-0.1
Total financing	0.0	6.1	0.0	1.9	8.1	-1.1	2.7	0.1
Foreign (net)	4.7	4.9	2.5	3.3	0.8	1.0	6.5	3.3
BOP gap	0.0	0.0	0.0	0.0	0.0	0.0	3.2	0.0
Borrowing	9.0	9.2	5.8	7.1	3.8	4.2	6.6	6.6
Amortization	-3.6	-4.5	-3.1	-3.3	-2.8	-3.3	-3.2	-3.3
Special loans (net)	-0.8	0.2	-0.1	-0.5	-0.2	0.0	-0.1	0.0
Domestic (net)	-4.6	1.2	-2.6	-1.4	7.3	-2.0	-3.7	-3.2
Discrepancy	0.0	0.3	0.0	0.0	-0.9	0.0	0.0	0.0
Memorandum items:								
Domestic balance 2/	-1.3	-4.7	-1.2	-5.0	-8.1	-2.9	-5.4	-3.2
Domestic primary balance 3/	1.4	-1.7	-0.3	-1.8	-3.7	-1.2	-2.2	-2.3
Propoor expenditure (excl. donor-funded projects)	...	3.3	...	...	5.1	...	5.9	6.2
Total financing target 4/	0.0	6.9	0.0	0.0	8.5	4.4	6.8	4.7
Nominal GDP (in millions of kwacha)	113,923	113,828	131,764	132,888	135,021	146,191	150,794	165,628

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

1/ Fiscal year begins in July; information for 2001 refers to fiscal-year 2001/02, etc.

2/ Overall balance excluding grants, foreign-financed development expenditure and foreign interest payments.

3/ Domestic balance, excluding domestic interest payments.

4/ Total financing and grants, excluding foreign project-related financing.

Table 3. Malawi: Monetary Authorities' Balance Sheet, 2000-05
(In millions of Malawi kwacha, unless otherwise indicated)

	2000 Dec.		2001 Dec.			2002 May	2002 June	2002 Sep.	2002 Dec.		2003 Dec.	2004 Dec.	2005 Dec.
	EBS/00/263	Actual	EBS/00/263	EBS/01/90	Actual	Actual	Proj.	Proj.	EBS/01/90	Proj.		Proj.	
Reserve money 1/	6,996	6,756	7,961	7,542	7,665	9,051	8,849	9,002	8,220	8,236	9,005	9,818	10,710
Currency outside RBM	...	4,145	...	...	4,209	5,822	...	...	...	4,872	5,362	5,752	5,988
Commercial bank deposits with RBM	...	2,611	...	...	3,456	3,229	...	...	...	3,363	3,643	4,066	4,722
Net foreign assets (NFA) of the monetary authorities 2/	9,388	11,289	14,998	15,980	8,769	7,867	7,516	6,372	19,260	4,478	12,138	17,521	22,265
NFA of the monetary authorities (in millions of U.S. dollars)	121	141	183	212	130	104	98	81	251	56	149	212	267
Gross foreign assets of the monetary authorities	226	244	278	305	203	177	168	151	352	131	230	280	321
Foreign liabilities of the monetary authorities	-104	-103	-94	-93	-73	-73	-70	-70	-101	-75	-81	-68	-54
Net domestic assets of the monetary authorities	-2,392	-4,533	-7,037	-8,439	-1,104	1,184	1,333	2,630	-11,040	3,757	-3,133	-7,704	-11,555
Credit to government (net)	-552	-1,068	-5,472	-4,243	3,663	3,016	6,782	7,222	-6,743	5,888	-957	-7,706	-14,661
Credit to statutory bodies (net) 3/	288	296	300	300	166	286	287	2,107	296	3,801	287	287	287
Credit to domestic banks	27	112	30	22	4	44	3	3	27	3	3	3	3
Other items (net)	-2,154	-3,874	-1,894	-4,518	-4,937	-2,162	-5,740	-6,702	-4,622	-5,935	-2,466	-289	2,815
Revaluation accounts	-4,163	-4,550	-4,853	-3,503	-1,653	-2,525	-2,608	-2,735	-3,828	-2,798	-2,888	-3,052	-3,230
Open market operations: holdings of monetary policy bills	711	-1,263	1,662	-3,392	-7,746	-6,338	-9,027	-10,105	-3,171	-9,906	-8,038	-6,501	-3,869
Others	1,297	1,939	1,297	2,377	4,462	6,700	5,896	6,138	2,377	6,768	8,460	9,264	9,914
Memorandum items:													
12-month percentage change in reserve money	18.0	13.9	13.8	11.6	13.5	9.8	12.7	5.4	9.0	7.4	9.3	9.0	9.1
Money multiplier	2.00	2.43	2.05	2.49	2.26	2.31	2.40	2.45	2.53	2.41	2.50	2.61	2.71
Currency-deposit ratio	0.35	0.34	0.35	0.31	0.30	0.39	...	...	0.31	0.32	0.31	0.29	0.26
Reserve-deposit ratio	0.25	0.21	0.23	0.22	0.28	0.21	...	...	0.21	0.22	0.21	0.21	0.21

Sources: Reserve Bank of Malawi (RBM); and Fund staff estimates and projections.

1/ To adjust for a temporary contraction at end-December 2000, reserve money is calculated as the simple average of reserve money on December 22 and 29, 2000, and January 5, 2001.
To adjust for a temporary expansion at end-December 2001, reserve money is calculated by adjusting for excess reserves of MK 500 million on December 31, 2001.
2/ For actuals, reserve money and NFA are calculated at the actual end-period exchange rate; for projections, reserve money and NFA are calculated at the projected end-period exchange rate.
3/ Includes net lending to the National Food Reserve Agency (NFRA) for the 2002/03 maize imports.

Table 4. Malawi: Monetary Survey, 2000-05
(In millions of Malawi kwacha, unless otherwise indicated)

	2000 Dec.		2001 Dec.			2002 May	2002 June	2002 Sep.	2002 Dec.		2003 Dec.	2004 Dec.	2005 Dec.
	EBS/00/263	Actual	EBS/00/263	EBS/01/90	Actual	Actual	Proj.	Proj.	EBS/01/90	Proj.		Proj.	
Money and quasi money 1/	13,958	16,444	16,309	18,746	18,438	20,928	21,242	22,087	20,828	19,887	22,548	25,585	29,020
Money	...	8,771	...	...	9,312	11,158	...	...	...	...	...	...	...
Quasi money	...	7,673	...	...	9,126	9,770	...	...	...	...	...	...	...
Net foreign assets (NFA) of the banking system 1/	12,442	14,252	19,004	19,140	11,777	10,235	11,058	10,140	22,944	8,553	16,866	22,974	28,525
NFA of the banking system (in millions of U.S. dollars)	161	178	233	254	175	135	144	129	299	107	207	278	342
Gross foreign assets of the banking system	279	297	345	358	263	223	228	213	415	197	305	366	418
Foreign liabilities of the banking system	-118	-119	-112	-103	-88	-88	-84	-84	-116	-90	-98	-88	-76
Monetary authorities	9,388	11,289	14,998	15,980	8,769	7,867	7,516	6,372	19,260	4,478	12,138	17,521	22,265
NFA of the monetary authorities (in millions of U.S. dollars)	121	141	184	212	130	104	98	81	251	56	149	212	267
Commercial banks	3,054	2,964	4,007	3,159	3,009	2,368	3,542	3,768	3,684	4,075	4,728	5,453	6,260
NFA of the commercial banks (in millions of U.S. dollars)	40	37	49	42	45	31	46	48	48	51	58	66	75
Net domestic assets (NDA) of the banking system	1,516	2,192	-2,696	-393	6,661	10,693	10,185	11,948	-2,116	11,334	5,682	2,611	496
Credit to government (net)	-365	117	-6,153	-4,159	5,661	6,633	9,348	9,487	-6,659	7,887	1,042	-5,707	-12,662
Credit to statutory bodies (net) 2/	1,418	1,047	1,559	683	-45	282	397	2,216	683	3,910	397	397	397
Credit to private sector	5,123	5,044	7,440	5,916	5,289	5,861	6,168	6,281	7,082	6,421	9,432	11,800	14,242
Other items (net)	-4,659	-4,016	-5,542	-2,833	-4,244	-2,083	-5,728	-6,037	-3,222	-6,884	-5,189	-3,879	-1,480
Revaluation accounts	-5,299	-5,845	-6,182	-4,606	-2,377	-3,586	-3,714	-3,913	-4,995	-4,043	-4,215	-4,442	-4,676
Open market operations: holdings of monetary policy bills	...	-743	...	...	-6,829	-5,534	-7,827	-8,105	...	-8,989	-7,121	-5,584	-2,952
Others	640	1,829	640	1,772	4,962	7,037	5,814	5,980	1,773	6,147	6,147	6,147	6,147
Memorandum items:													
Velocity of money (annual GDP divided by period-average broad money)	8.1	7.3	8.2	7.0	7.0	...	...	...	6.6	7.3	7.2	7.0	6.8
Broad money (12-month percentage change)	20.9	42.4	16.8	14.0	12.1	6.7	5.9	17.7	11.1	7.9	13.4	13.5	13.4
Private sector credit (12-month percentage change)	52.2	49.9	45.2	17.3	3.2	13.2	37.7	22.1	19.7	21.4	46.9	25.1	20.7

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

1/ For actuals, broad money and NFA are calculated at the actual end-period exchange rate; for projections, broad money and NFA are calculated at the projected end-period exchange rate.
2/ Includes net lending to the National Food Reserve Agency (NFRA) for the 2002/03 maize imports.

Table 5. Malawi: Balance of Payments, 2000-07
(In millions of U.S. dollars; unless otherwise specified)

	2000			2001			2002		2003	2004	2005	2006	2007
	EBS/00/263	EBS/01/90	Act.	EBS/00/263	EBS/01/90	Act.	EBS/01/90	Proj.			Proj.		
Current account balance (including grants)	-135.0	-81.9	-89.0	-120.1	-67.7	-127.7	-110.6	-214.4	-131.3	-119.9	-120.9	-111.3	-115.9
Trade balance	-194.2	-163 6	-157.7	-176 0	-138.3	-175.4	-184.7	-347.1	-205.9	-211.9	-217.9	-221.8	-226.0
Exports	430.9	405.5	405.5	438 4	442.3	406.8	474.5	421.1	451.2	481.3	513.5	542.5	572 7
Of which: tobacco	...	246.8	246.8	...	273.0	236.0	290.5	243.0	259 7	275.7	292.6	306.7	321.5
tea, sugar, and coffee	...	81.4	81.4	...	81.2	97.1	85.8	100.7	106.9	113.7	120.9	127.4	133.7
nontraditional exports	...	55.7	55.7	...	66.6	59.9	75.4	63.5	69.5	75.8	82.7	90.2	98.4
Imports	-625.2	-569.1	-563.2	-614.4	-580.6	-582.2	-659.2	-768.2	-657.1	-693.3	-731.4	-764.3	-798.7
Of which: petroleum	...	64.7	74.5	...	59.8	68.0	55.0	69.9	69.1	68.7	68.2	69.5	72.5
maize	...	0.0	0.0	...	0.0	8.5	0.0	26.5	0.0	0.0	0.0	0.0	0.0
Projected future maize imports								110.2					
Donors 1/								41.0					
Government 2/								69.2					
Services balance	-80.0	-74.7	-86.9	-76.3	-84.9	-65.5	-100.3	-166.4	-91.1	-94.8	-104.6	-109.0	-114.0
Interest public sector (net)	-22.3	-13.0	-20.6	-16.6	-12.8	-17.8	-11 8	-26.8	-23.1	-16.8	-13.2	-10.7	-8.4
Receipts	8.7	15.8	12.1	13.8	15.2	8.7	17.5	2.4	5.8	11.7	15.0	17.1	19.2
Payments (amounts due before debt relief)	-31.0	-28.8	-32.7	-30.4	-28.0	-26.5	-29.3	-29.2	-29.0	-28.5	-28.1	-27.8	-27.6
Other factor payments (net)	-19.3	-22.2	-17.7	-19.9	-24.6	-14.6	-25.6	-14.8	-15.5	-16.3	-17.2	-18.1	-19.1
Nonfactor (net)	-38.4	-39.5	-48.7	-39.8	-47.4	-33.1	-62.9	-124.8	-52.5	-61.7	-74.2	-80.1	-86.4
Receipts	41.6	39.9	45.3	42.6	40.7	48.7	41.5	49.2	50.1	51.1	52.1	53.2	54.2
Payments	-80.0	-79.4	-93.9	-82.4	-88.1	-81.8	-104.4	-91.6	-102.6	-112.8	-126.3	-133.3	-140.6
Maize-related payments 3/								-82.4					
Unrequited transfers (net)	139.1	156.4	155.6	132.2	155.5	113.2	174.4	299.1	165.6	186.8	201.6	219.5	224.0
Private (net)	11.2	8.7	7.8	11.4	8.9	15.5	9.0	15.8	16.0	16.3	16.6	16.9	17.3
Receipts	21.8	22.7	21.8	22.3	23.2	21.8	23.6	22.3	22.5	22.9	23.4	23.9	24.3
Payments	-10.6	-14.1	-13.9	-10.9	-14.3	-6.3	-14.6	-6.5	-6.5	-6.7	-6.8	-6.9	-7.1
Official (net)	128.0	147.7	147.8	120.8	146.6	97.7	165.3	283.2	149.6	170.5	184.9	202.6	207.6
Receipts	128 6	148 4	148.4	121.4	147.3	98.3	166.0	283.8	150.3	171.2	185.6	203.2	208.3
Balance of payments (BOP) assistance	81.4	78.4	78.4	73.4	94.6	51.0	99.6	74.4	92.6	112 1	125.0	141.2	144 9
Japan HIPC								14.0					
Donor humanitarian grants 3/								133.7					
Project related	47.2	69.9	69.9	48.0	52.6	47.3	66.4	61.8	57.7	59 1	60.6	62.0	63.4
Drought related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0 6	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7
apital account balance (incl. errors and omissions)	103.6	70.0	78.2	142.5	91.0	96.2	101.6	109 7	112.7	113.8	117.7	117.0	117.4
Medium- and long-term flows	63.9	65.0	65.0	101.6	62.5	59.8	71.7	70.5	74.0	68 0	67.3	62.5	58.4
Disbursements	121.4	124.9	124.9	159.8	127.0	127.0	130.3	126.0	138.5	138.5	138.5	138.5	138.5
BOP support	31.4	31.4	31.4	77.8	55.0	55.0	54.7	45.0	52.6	54.7	56.8	58.9	60.9
Project support	90.0	93.5	93.5	82.0	72.0	72.0	75.6	81.0	85.9	83.8	81.7	79.6	77.6
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization (amounts due before debt relief)	-57.5	-59.9	-59.9	-58.2	-64.5	-67.2	-58.6	-55.5	-64.5	-70.5	-71.2	-76.0	-80.1
Foreign direct investment and other inflows	39.7	27.0	27.0	40.9	28.4	28.0	29.9	47.6	38.7	45.8	50.3	54.5	59 0
Short-term capital and errors and omissions	0.0	-22.0	-13.8	0.0	0.0	8.5	0.0	-8.5	0.0	0.0	0.0	0.0	0.0
verall balance	-31.5	-11.9	-10.8	22.4	23.3	-31.5	-9.0	-104.7	-18.6	-6.2	-3.3	5 7	1.5
nancing (-increase in reserves)	31.6	11.9	10.8	-72.0	-23.1	31.5	9.4	104.8	-41.4	6.1	3.3	-5.7	-1.5
Central bank	37.6	17.6	16.6	-62.0	-71.4	11.8	-38.0	73.3	-92.5	-63.1	-54.7	-55.1	-47.7
Gross reserves (-increase)	20.2	1.7	1.7	-52.2	-61.5	40.7	-46.7	71.9	-98.5	-50.4	-40.7	-44.3	-40.0
Liabilities	17.4	15.9	14.9	-9.7	-9.9	-28.9	8.6	1.3	6.0	-12.8	-14.0	-10.9	-7.7
Of which: IMF (net)	-0.1	-0.8	-1.8	10.3	9.3	-7.8	8.6	0.3	5.9	-12.9	-14.2	-11.0	-7.8
Purchases/drawings	8.9	8.4	8.4	17.8	16.8	0.0	16.8	8.1	16.1	0.0	0.0	0.0	0.0
Repurchases/repayments	-9.0	-9.2	-10.2	-7.5	-7.5	-7.8	-8.2	-7.8	-10.2	-12.9	-14.2	-11.0	-7.8
Commercial banks	-6.0	-5.7	-5.7	0.0	-5.0	-7.7	-6.0	-6.0	-7.0	-8.0	-9.0	-10.0	-10.5
Arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	0.0	0.0	0.0	31 1	53.3	27.4	53.4	37.5	58.1	77.3	67.0	59.4	56.7
Residual financing gap (+ = underfinanced)		0.0	0.0	18.5	-0.2	0.0	-0.4	0.0	60 0	0.0	0.0	0.0	0.0
emorandum items:													
Gross official reserves													
In millions of U.S. dollars	224.0	242.5	242.5	276.1	304.0	201.8	350.7	129.9	228.4	278.8	319.5	363 8	403.8
In months of imports 4/	3.9	4.4	4.4	4.7	4.8	2.8	5.3	2.1	3.4	3.9	4.3	4 6	4.9
In months of imports 5/	3.5	...	4.4	4.8	5.5	3.6	5.5	1.8	3.6	4.1	4.5	4.9	5.2
Current account balance (percent of GDP)													
Excluding official transfers	-15.2	-13.6	-14.2	-12.2	-13.3	-12.9	-15.0	-26.2	-14.4	-13.8	-13.4	-12.4	-12.0
Including official transfers	-7.8	-4.8	-5.3	-6.7	-4.2	-7.3	-6.0	-11.3	-6.7	-5.7	-5.3	-4.4	-4.3
Export value growth (in percent)	-3.6	-9.3	-9.3	2.0	9.1	0.3	7.3	3.5	7.1	6.7	6.7	5.7	5.6
Import value growth excl. foodstuff (in percent)	-7.2	-15.5	-16.4	-1.7	2.0	1.9	13.5	8.5	4.7	5.5	5.5	4.5	4.5
Prospective BOP financing (grants & loans) (millions of US$)	...	...	...	...	149.6	106.0	154.3	119.4	145.2	166.8	181.8	200.0	205.9
Identified financing	...	...	...	...	149.6	106.0	123.0	119.4	88.0	0.0	0.0	0 0	0.0
Financing expected but not yet confirmed	...	...	...	...	0.0	0.0	31.3	0.0	57.2	166.8	181.8	200.0	205.9

ources: Malawian authorities; and staff estimates and projections.

Donor food imports provided for humanitarian aid; amount provided by UN Consolidated Appeal in Response to the Humanitarian Crisis, 2002/03.
Government imports of 250,000 metric tons, including 53,000 metric tons for the restocking of the NFRA.
Costs related to humanitarian imports; amount provided by UN Consolidated Appeal in Response to the Humanitarian Crisis, 2002/03.
In months of following year's imports of goods and nonfactor services.
In months of current year's imports of goods and nonfactor services.

Table 6. Malawi: Implementation of Structural Performance Criteria and Benchmarks Under the PRGF Arrangement

Measure	Status
Structural performance criteria	
Compilation by the Ministry of Finance of monthly reviews that (i) summarize the monthly reports by line ministries on commitment levels and arrears and (ii) assess prospects for meeting budget targets in 2000/01.	Not implemented.
Commencement of full operations, by end-December 2000, of a unit in the Ministry of Finance to monitor the activities of parastatals, including quarterly borrowing returns and the provision of annual accounts, and completion of the first quarterly report on ten parastatals before December 31, 2000.	Implemented.
Avoidance of any new borrowing by the National Food Reserve Agency (NFRA).	Breached in September 2001; implemented since then.
Structural benchmarks	
Receipt from line ministries of 100 percent of monthly returns under the new commitment control system (CCS), starting with returns from December 2000.	Partially implemented. Only two-thirds of agencies and ministries submitted CCS returns for December 2000. Although the quality remains weak, timely submission of returns has been improving over time.
Dissemination of quarterly reports on spending on priority (poverty-related) programs starting with the third quarter of 2000 and with target publication date of one month after the end of the quarter.	Partially implemented. The quarterly reports have not been systematically disseminated.
Maintenance of uniform access by all growers to the tobacco sales network and preservation of the intermediate buyers' system or equivalent mechanism.	Implemented.
Pursuit by official investigators and prosecutors of all evidence of fraud, corruption, and misappropriation of public funds identified in the reports of the Auditor General, particularly in the cases of the Petroleum Control Commission (PCC) and public procurement.	Partially implemented. In the PCC case, some of the misappropriated funds have been recovered, and further leads are being pursued. As regards public procurement, a number of contractors identified to have engaged in fraudulent activities have been put on bail, and three ministers were released from the cabinet.
Recovery, by February 2001, of at least MK 150 million of revenue lost through tax evasion—and application of available penalties—as assessed by the Malawi Revenue Authority (MRA), particularly in the case of large customs duties outstanding; and pursuit of any associated cases of corruption.	Not implemented. The MRA could not provide sufficient evidence to pursue the case of large import duties outstanding and the case has been closed.
Removal of legal obstacles preventing implementation of a complete book-entry system for government securities before end-2000.	Implemented in May 2001.
Formalization of the system for authorizing parastatal borrowing by April 2001.	Delayed from April 2001 to September 2002.

Table 7. Malawi: Pro-Poor Current Expenditure (PPEs), 2000/01-2002/03 1/
(In percent of GDP, unless otherwise indicated)

Ministry/Department	2000/01	2001/02			2002/03	
	Actual	Approved budget	Revised budget	Annual change	Budget	Annual change
Total pro-poor expenditure	3.3	6.0	5.1	1.7	5.9	0.8
Agriculture	0.2	0.3	0.3	0.1	0.4	0.1
Agricultural extension	0.1	0.2	0.1	0.1	0.1	-0.1
Small-scale irrigation	0.0	0.0	0.0	0.0	0.1	0.1
Targeted Input Program	0.2	0.1	0.1	0.0	0.2	0.0
Water	0.2	0.3	0.2	0.0	0.1	-0.1
Rural water supplies	0.0	0.1	0.1	0.0	0.0	0.0
Development projects	0.2	0.3	0.2	0.0	0.1	-0.1
Education	2.2	3.0	2.6	0.4	3.1	0.5
Primary education	1.8	2.1	2.3	0.5	2.5	0.2
Of which: teaching materials	0.1	0.5	0.5	0.4	0.3	-0.2
Of which: teachers' salaries	1.6	1.1	1.7	0.1	1.6	-0.1
Secondary education	0.4	0.6	0.2	-0.2	0.2	0.1
Teacher training	0.1	0.3	0.1	0.0	0.3	0.2
Teachers' housing	0.0	0.0	0.0	0.0	0.1	0.1
Health	0.6	1.6	1.1	0.5	0.9	-0.2
Primary health care	0.3	0.8	0.6	0.3	0.3	-0.3
Preventive health care	0.0	0.0	0.0	0.0	0.0	0.0
Secondary curative care	0.3	0.8	0.5	0.2	0.6	0.1
Of which: drugs	0.7	0.8	0.6	-0.1	0.7	0.1
Of which: health workers' salaries	0.5	0.6	0.6	0.1	0.6	0.0
Gender, Youth and Community Services	0.0	0.1	0.1	0.0	0.0	0.0
Family welfare services	0.0	0.0	0.0	0.0	0.0	0.0
Children services	0.0	0.0	0.0	0.0	0.0	0.0
National adult literacy education services	0.0	0.1	0.0	0.0	0.0	0.0
Police	0.0	0.0	0.0	0.0	0.2	0.2
Community policing	0.0	0.0	0.0	0.0	0.1	0.1
Training	0.0	0.0	0.0	0.0	0.1	0.1
Other	0.1	0.8	0.8	0.7	1.2	0.4
Rural feeder roads	0.1	0.3	0.6	0.5	0.9	0.4
Small-scale mining	0.0	0.1	0.0	0.0	0.0	0.0
Small-scale fish farming	0.0	0.0	0.0	0.0	0.0	0.0
Technical and vocational training	0.0	0.2	0.1	0.1	0.1	0.0
SME promotion	0.0	0.1	0.0	0.0	0.0	0.0
Gender mainstreaming	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:						
Nominal GDP (in millions of kwacha)	113,828	135,021	135,021	135,021	150,794	150,794

Source: Malawian authorities.

1/ Fiscal year begins in July; information for 2001 refers to fiscal-year 2001/02, etc.

Table 8. Malawi: Implementation Status of Actions to Strengthen the Tracking of Poverty-Reducing Public Spending
As of end-June 2002

	Actions	Timing (S/M)[1]	Status (FI/II/NS)[2]	Date Achieved	Comments
Comprehensiveness					
1	Bring comprehensiveness into review of Finance and Audit Act	S	FI	May 2002	The draft legislation is completed.
2	Amend comprehensiveness in line with *GFS Manual*	M	NS		
3	Implement IFMIS	S	II		Pilot implementation started.
4	Continue IFMIS	M	NS		
5	Bolster consistent approach to budget support with all donors, and increase the predictability of flows	S	II		
6	Specify PPEs in detail in terms of programs, subprograms, and economic objects	S	II		Technical work completed.
Multiyear projections					
7	Roll-over 2002-03 estimates from MTEF for start of 2002 budget process	S	II		
Internal controls					
8	Assign central agency responsibility for internal audit	S	II		No final decision has been taken.
9	Bolster internal audit through allocating central agency responsibilities and developing manuals, etc.	M	NS		
10	Introduce CCA for PPEs	S	NS		Contingent upon technical assessment
11	Procurement reform	S	II		
Reconciliation					
12	Continue program to update routine reconciliation process in preparation for IFMIS	S	II		Part of the roll out of IFMIS.
Reporting					
13	Implement IFMIS	S	II		
14	Data quality	S	II		Fiscal advisor in place since May 2002.
Final audited accounts					
15	Institutional strengthening – audit	S	NS		

[1] S=Short term action; M=medium term action.
[2] FI=fully implemented, II=Implementation initiated, NS=Not started.

July 19, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler,

On December 21, 2000 the Executive Board approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement aimed at bringing down inflation, accelerating growth and reducing poverty. In the attached memorandum on economic policies, we report on progress in implementing our program supported by the PRGF arrangement and describe the economic and financial policies for 2002.

As the implementation of the program has been unsatisfactory, the government of Malawi is intent on establishing a strong track record correcting the fiscal stance, adhering to the monetary program, and implementing the delayed structural reforms as prior actions as outlined in the attached memorandum on economic policies. This will enable the government to reach the objectives set forth in the Malawi Poverty Reduction Strategy Paper (MPRSP) and the December 8, 2000 memorandum on economic policies.

Sincerely yours,

/s/ /s/

Dr. Ellias E. Ngalande
Governor
Reserve Bank of Malawi

Mr. Friday A. Jumbe
Minister of Finance and
Economic Planning

MALAWI

Memorandum on the Economic Policies of the Government of Malawi

July 19, 2002

I. BACKGROUND AND PROGRAM IMPLEMENTATION

1. **The implementation of our economic reform program was not satisfactory and the macroeconomic situation remains tenuous as private sector activity is being strained by expansionary fiscal policies.** While monetary policy has been tight, and the core inflation has declined to less than 10 percent, real interest rates remain very high, reflecting the expansionary fiscal stance combined with persistent inflation expectations. The fiscal program has been derailed by several major bailouts of parastatals, overspending on the wage bill and travel, and revenue shortfalls from tax cuts, a decline in firms' profitability, and depressed demand for dutiable imports. Growth is likely to have been negative last year and is forecast to stay below 2 percent in 2002. Moreover, Malawi is now faced with a serious food situation, and large shortages are expected later in 2002.

2. **The Malawi Poverty Reduction Strategy Paper (MPRSP), launched on April 24, 2002, identifies as the main challenge for poverty reduction a move to a higher growth path through private sector development.** The MPRSP is built around four strategic pillars. The first consists of strategies that will enhance rapid, sustainable, pro-poor economic growth and structural transformation. The second focuses on human capital development. The third pillar involves strategies to improve the quality of life of the most vulnerable. And the fourth pillar covers issues of good governance. Key obstacles to private sector development, particularly in the crucial agricultural sector, are the following: the lack of macroeconomic stability, the still considerable involvement of government in the economy, especially through the parastatal sector, and weaknesses in governance. The economic and structural policies described in this letter emanate from the MPRSP (as indicated by chapter references to the MPRSP) and address these obstacles.

3. **The prolonged period of fiscal borrowing and its effect on interest rates have started to create unsustainable debt dynamics, is crowding out the private sector, and has weakened growth. To turn around this situation and move Malawi toward a higher growth trajectory, we are committed to implementing the following three-pronged strategy (Chapter 5.2.2.1).** First, we have been containing expenditure since March 2002 and will implement a 2002/03 (July - June) budget that envisages an ambitious fiscal adjustment to reverse the fiscal expansion of the last two years. At the same time, the 2002/03 budget makes further room for spending that benefits the poor. Second, a strengthened expenditure management system will enable us to closely monitor the implementation of fiscal policies. Third, we will accelerate parastatal reform to avoid future recourse to bailouts from the budget. This strategy will help make the domestic debt situation more manageable and create the room needed for private sector development.

4. **Consistent with attaining the objective of macroeconomic stability, we target a further reduction in end-period inflation to 5 percent in 2002.** To this end, the Reserve Bank of Malawi (RBM) will continue to keep a tight monetary stance. In tandem with the fiscal adjustment, this monetary stance will lead to a reduction in interest rates and a rebound in private sector activity.

II. Policies and Measures for 2002

A. Disaster Relief

5. **With regard to the food shortages expected for later this year, pledges of humanitarian aid broadly cover the estimated food aid requirements and the government will undertake commercial food imports through the National Food Reserve Agency (NFRA) to ensure that sufficient quantities of food are available in Malawi.** Moreover, the government will provide a subsidy estimated at 1.1 percent of GDP, mostly benefiting the segment of the population that is expected to be outside the target group for food aid but has insufficient income to fully satisfy the minimum caloric requirement at import parity prices.

6. **The government will address the operational weaknesses in the implementation of the current food security strategy that failed to prevent this year's food crisis.** Our food security policy is based on four pillars: early warning systems to monitor the food situation and indicate shortages between six and nine months in advance; a physical buffer stock of between 30,000 and 60,000 metric tons to address a short-term emergency; sufficient international reserves at the central bank to finance any imports for a more prolonged crisis; and social safety net programs to meet the food needs of the poor. However, during 2001, an immediate response to the food crisis was compromised as the crucial early warning systems turned out to be relying on flawed agricultural crop estimates. This failure had tragic consequences as we relied on these systems and had sold off almost the entire buffer stock as part of the process to replenish it with the maize from the approaching harvest. The government has since transferred the responsibility of producing agricultural crop estimates to the National Statistical Office (NSO) and decided to undertake an external audit financed by donor assistance of the sale of the buffer stock. All elements of the forthcoming food security operation will be set out transparently, clearly communicated to the public, and carefully monitored and controlled, including through civil society participation.

B. Fiscal Policy

7. The overall financial envelope for the 2002/03 budget envisages a reduction in the domestic deficit to 5½ percent of GDP from 8 percent of GDP in 2001/02. The adjustment in the 2002/03 budget will come from the trimming down of nonpriority expenditure (2¼ percent of GDP), the enhancement of revenue (1¼ percent of GDP), and savings from the interest bill (1 percent of GDP). But the 2002/03 budget will also increase the allocation to priority pro-poor expenditure (PPE) by ¾ of one percent of GDP, building upon the

already higher allocation for PPEs in the 2001/02 budget (which increased by 1¾ percent of GDP), while ensuring food security through a maize subsidy (about 1 percent of GDP). To support the implementation of the budget, we have strengthened expenditure control and introduced a system for tracking pro-poor spending, so as to enable MPRSP stakeholders to monitor the budget execution.

8. **Most of the adjustment will come from cutting back nonpriority expenditure.** To that end, the government will:

- extend through 2002/03 the new guidelines on travel policy on both internal and external travel;
- cancel or scale back low-priority projects in the development budget, including certain housing projects for teachers, elderly, chiefs, and soldiers; and
- audit the payroll, initially in the Ministries of Education, Health, Agriculture, Police, and Defense by end-June 2002, to remove "ghost" workers and prevent the continued overfunding of the wage bill.

9. **To ensure a decisive turnaround, the government will also implement tax measures.** We intend to:

- effect the extension of the surtax to the retail stage in September 2002;
- introduce a new personal income tax bracket (40 percent) for high-income earners with the budget;
- increase excise rates on motor vehicles, and alcohol with the budget;
- introduce a 20 percent export tax on raw, unprocessed tobacco to counter tax evasion on tobacco circumventing the auction floors;
- curtail drastically discretionary duty exemptions other than on donations or imports by diplomatic missions, NGOs and international organizations to counteract the recent increase in nondutiable imports with the budget; and
- build up capacity in the Malawi Revenue Authority (MRA) to strengthen tax administration including by carrying out effective and well-targeted audit programs to strengthen enforcement.

10. **On expenditure control measures (Chapter 4.4.3.1), we will enhance the operation of the Credit Ceiling Authority (CCA) system by end-July 2002 by:**

- the Reserve Bank of Malawi (RBM) and the Accountant General (A-G) setting up holding and subholding accounts corresponding to all operating accounts with commercial banks;
- ensuring consistent and timely recording of all funding and reimbursement transactions;
- assigning A-G staff to the RBM to support the reimbursement process, so as to ensure that the reimbursement claims are made within the respective credit ceilings against the line ministry holding accounts;

- eliminating unused budget balances in the CCA system carried forward between fiscal years within one month after the end of the fiscal year; and
- the Secretary to the Treasury issuing a circular, with support from the Secretary to the President and the Cabinet, to controlling officers on clear performance expectations for financial management and integrating these into their performance-based employment contracts.

11. **To protect execution of the pro-poor oriented part of the 2002/03 budget, the government will put in place a monitoring and control framework to track pro-poor expenditure (Chapter 6.3.1), consisting of the following elements:**

- Based on the MPRSP, the 2002/03 budget is transparently identifying PPE programs and subprograms with a direct poverty-alleviating impact, which will be prioritized and protected with regard to budget execution.
- The Ministry of Finance will, if feasible, introduce a separate CCA for PPEs with effect from July 2002 to ensure that funding is not diverted to low-priority expenditure.
- Expenditure on PPEs will be tracked using the existing reporting mechanism from line ministries on a monthly basis and made publicly available through the website and newspapers.

12. **To facilitate expenditure management, the monitoring and analysis of the budget will be strengthened by (Chapter 6.3):**

- improving the existing reporting systems, so as to develop more reliable and timely expenditure and revenue reports;
- ensuring proper reconciliation of the various data sets (e.g., the CCA, Commitment Ceiling System, expenditure returns, and donor funding reports);
- undertaking a timely monthly reconciliation of line ministry expenditure data with banking data;
- compiling monthly consolidated fiscal reports for policymakers, so as to facilitate better monitoring and analysis of fiscal policy; and
- submitting monthly expenditure and financing reports to the Cabinet Committee on the Economy.

13. **In addition, we will also address the following areas:**

- *Wage policy* (Chapter *4.4.3.2)*. The government is developing a medium-term wage policy linked to civil service reform to improve wage competitiveness, lower attrition rates, and strengthen public sector performance. To support this policy, the government will complete a comprehensive review on civil service remuneration policy to adjust internal and external job relativities, and it will introduce a new policy with the 2003/04 budget in conjunction with the implementation of the functional reviews. The reform will streamline, prioritize, and make more effective the operations of government.

- *Arrears data.* The government will undertake the following actions for monitoring and preventing arrears:

    a. undertake by September 2002, a comprehensive inventory of all payment arrears as of June 30, 2002 by the Auditor General and the Ministry of Finance, if needed with support from external auditors;
    b. strengthen the sharing of information among the Ministry of Finance, Auditor General, and line ministries in line with the agreed memorandum of understanding of March 2001;
    c. extend the agency payment system in the Accountant General's Office to a number of line ministries experiencing a large accumulation of utility arrears; and
    d. discharge any new expenditure arrears within the current budgetary allocations of line ministries and continue not to carry out offsetting operations.

C. Structural Reforms

14. **The MPRSP emphasizes that progress in parastatal reform is essential to achieve the macroeconomic, poverty-reduction, and growth objectives.**

- To reduce mismanagement and facilitate the restructuring and commercialization of the parastatals, the government will strengthen the monitoring and control of their operations and borrowing activities by (Chapter 5.2.2.1):

    a. developing and adopting by September 2002 the authorization system for borrowing by parastatals. Any borrowing by parastatals must have Ministry of Finance approval; and
    b. reaching an agreement by September 2002 with all parastatals on a repayment schedule for domestic arrears.

- The government will continue commercializing the Agricultural Development and Marketing Corporation (ADMARC) in preparation for its privatization (Chapter 4.4.3.2). The following schedule of actions has been developed:

    a. Following the audit of ADMARC's operational and financial activities in February 2001, the costs of operating nonprofitable agricultural markets has been budgeted for 2002/03. The process of commercializing these retail outlets will be completed by March 2003.
    b. Following the transfer of ADMARC's subsidiaries (David Whitehead and Sons, Shire Bus Lines, Grain and Milling, and Cold Storage) to the Ministry of Finance in early 2002, the government audited the main companies. The cabinet will by end-July 2002 issue a directive on the divestiture options and

will complete the process to privatize or liquidate these subsidiaries by end-2002. The liquidation of David Whitehead and Sons will be initiated by July 2002. Furthermore, the government has instructed ADMARC Investment Holding Company to divest its minority shareholdings (in particular SUCOMA and National Bank). The proceeds will be used to retire central government domestic debt. In cases without commercial value, the government will seek to close down the companies, so that they do not become a drain on the central government's budget.

c. Finally, the draft legislation repealing the ADMARC Act will be submitted to parliament by end-September 2002. The government guarantees on ADMARC's external credit lines have expired, and no new ones will be extended.

- The government will also privatize the Malawi Development Corporation's two main subsidiaries, Sunbird Tourism and Malawi Property Investment Company, by end-2002. The transactions for Malawi Telecom Limited (MTL) and Air Malawi (Chapter 4.4.3.2) will also be completed by end-2002. The Commercial Bank of Malawi was privatized in December 2001.

D. Governance

15. **We are committed to improving governance (Chapter 4.4.1.1). Thus, the government has:**

- submitted for the review by the Law Commission the draft amendment to the Corrupt Practices Act, with the aim of presenting a revised draft to parliament by end-2002; this draft will specify a level of proof that ensures an expedient corruption prosecution process, make abuse of offices an offense under the Corrupt Practices Act, and establish a "whistle-blower" program;
- established a program to train magistrates in interpreting the Corrupt Practices Act that will be implemented immediately (after financing becomes available); and
- increased the staffing levels of the Anti-Corruption Bureau (ACB) substantially and will further increase staff, particularly in the investigative branch.

E. Monetary Policy

16. **The RBM will continue to use the broad money stock (M2) as the nominal anchor to control inflation, with reserve money as the operational target.** For 2002, annual inflation is targeted at 5 percent; to this end, the RBM will limit year-end reserve money growth to less than 8 percent. The principal instruments to achieve these targets will be open market operations (Chapter 5.2.2.2).

17. **Consistent with the use of money as the nominal anchor, the exchange rate of the kwacha will remain market determined.** The RBM's intervention will therefore be limited to meeting the net official reserves target and smoothing exchange rate movements.

18. The RBM will resume its comprehensive review of the financial sector regulatory framework, with a view to developing a medium-term action plan by June 2002. To strengthen it's financial reporting and controls, the RBM has created an oversight committee and developed a timetable to implement the recommendations of the Fund's safeguards assessment.

F. External Sector

19. **The government's trade strategy will focus on (Chapter 4.1.2.5)**

- meeting commitments to liberalize trade by 2008 with other Southern African Development Community (SADC) members under the free trade area launched in September 2000, in order to complete the process of removing all duties with its trading partners in the Common Market for Eastern and Southern Africa (COMESA) and to consolidate its commitments under the Regional Integration Facilitation Forum (RIFF). The government will make efforts to ensure there is consistency between its various regional commitments; and
- removing recently imposed import license requirements on cement and sugar and import bans on dairy products, vegetable cooking oil, and dry cells by July 2002.

G. Statistics and Transparency

20. **Recent events have highlighted serious shortcomings in our core data bases that we will address by**

- urgently reviewing our system for projecting crop estimates to establish a more reliable system in time for the harvest in 2003;
- providing adequate funding for, and recruitment to, the NSO and its relocation to Lilongwe by December 2003; and
- developing an action plan for improving the quality of statistical information, particularly regarding data on sectoral national accounts, trade statistics, and the consumer price index.

21. Indicative quantitative targets of our economic program for the period through end-December 2002 are presented in Table 1. The prior actions and structural benchmarks are set out in Table 2.

22. We are firmly committed to implementing the policies set out above to bring our economic program back on track.

Table 1. Malawi: Quantitative Targets Under the PRGF Arrangement, 2002 1/
(In millions of Malawi kwacha, unless otherwise indicated)

	2002 End-June Rev. Prog.	2002 End-Sep. Rev. Prog.	2002 End-Dec. Rev. Prog.
Ceiling on the stock of reserve money 2/ 3/	8,019	8,855	8,623
Floor on the net foreign assets (NFA) of the monetary authorities 4/ (in millions of U.S. dollars)	98	81	56
Ceiling on the total financing of the central government 5/	6,069	2,812	5,249
Clearance of new domestic budgetary arrears 6/	...	...	...
Ceiling on the stock of external arrears 7/	0	0	0
Ceiling on contracting or guaranteeing of external debt by the central government and the Reserve Bank of Malawi (RBM)			
Medium and long term 8/	0	0	0
Short term 9/	0	0	0
Memorandum items:			
Baseline for balance of payments support for NFA adjuster (in millions of U.S. dollars) 10/	23	82	157

1/ Targets for reserve money, net foreign assets and external payment arrears relate to the respective stocks. All other targets for end-June are expressed as cumulative changes from December 31, 2001; and targets for end-September and end-December are expressed as cumulative changes from June 30, 2002. All targets are defined in the technical memorandum of understanding (TMU).
2/ The ceiling is set as an average of daily reserve money.
3/ The ceiling will be adjusted downward (upward) to reflect any decrease (increase) in the RBM reserve requirements on deposits.
4/ The floor will be adjusted downward (upward) for any shortfall (excess) of balance of payments support from its programmed levels, up to a maximum of US$50 million.
5/ The ceiling will be adjusted downward for any transfers from the RBM to the central government and upward for promissory notes issued to cover RBM's operational losses in 2001.
6/ Any new domestic budgetary arrears verified during the quarter, to be cleared by the end of the following quarter.
7/ Applicable on a continuous basis.
8/ Exclusions are specified in the TMU.
9/ Includes debt with maturity up to and including one year. Exclusions are specified in the TMU.
10/ Includes debt relief under the enhanced HIPC Initiative and excludes IMF disbursements. The adjuster is expressed cumulatively from December 31, 2001.

Table 2. Prior Actions and Structural Benchmarks

Prior Actions for the First Review	
Implementation of the tracking system of pro-poor spending, as agreed in the Memorandum of Understanding.	Partially done. The budget program classification will need to be extended to fully incorporate the final PRSP priorities.
Compilation by the Ministry of Finance of a consolidated fiscal report assessing the prospects for meeting budget targets.	Not done.
Issuance by the secretary to the treasury of a letter of financial expectations to controlling officers.	Not done.
Cabinet decision on the divestiture of ADMARC's noncore assets and transfer of control of David Whitehead and Sons to the Ministry of Finance.	Transfer of control completed. Cabinet decision on divestiture expected by end-July 2002.
Appointment of a Director for PERMU and appointment to parastatal boards.	Done.
Structural Benchmarks	
Developing authorization procedures and reporting requirements for parastatals' domestic and external borrowing.	Draft available.
Dissemination of monthly reports on spending on priority (poverty-related) programs with target publication date of one month after the end of the month.	Draft table available for spending through March 2002.
Development of a domestic debt management policy of the central government.	Draft available.
Timetable for the strengthening of statistical capabilities.	Draft available.
Quarterly reports by PERMU on parastatal financial statements and borrowing.	Quarterly reports prepared.

Malawi: Technical Memorandum of Understanding

1. This memorandum sets out the definitions for quantitative program targets under which Malawi's performance under the program supported by a Poverty Reduction and Growth Facility (PRGF) arrangement will be assessed. Monitoring procedures and reporting requirements are also specified.

I. Quantitative Program Targets

2. Targets for June 30, 2002, September 30, 2002, and December 31, 2002 have been established with respect to

- ceilings on the stock of reserve money;
- floors on the level of net foreign assets of the monetary authorities;
- ceilings on the cumulative total financing of the central government;
- clearance of new domestic budgetary arrears of the central government;
- ceilings on the contracting and guaranteeing by the central government or the Reserve Bank of Malawi (RBM) of medium- and long-term external debt; and
- ceilings on the contracting or guaranteeing by the central government or the RBM of short-term external debt.

3. A target that is applicable on a continuous basis has been established with respect to the ceilings on the stock of external arrears of the central government and the RBM.

II. Institutional Definitions

4. The central government includes all units of government that exercise authority over the entire economic territory. However, in contrast to the System of National Accounts (SNA) and government finance statistics (GFS) standards, nonprofit institutions that are controlled and financed by the central government are excluded for the purposes of this memorandum.

5. The accounts of the monetary authorities include the balance sheet of the RBM and the central government's holdings of international reserves.[1]

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[1] The counterpart entry to the central government's international reserve assets will be classified as "net credit to central government."

III. Limits on Monetary Aggregates

A. Reserve Money

6. A ceiling on the stock of reserve money applies. For the purposes of the program, the stock of reserve money for the quarter will be calculated as the arithmetic average (mean) of the stock of reserve money at all working days (Monday, Tuesday, Wednesday, Thursday, and Friday) in the quarter.

7. Reserve money consists of currency issued by the RBM and balances of commercial banks accounts with the RBM. It includes required reserves held for kwacha deposits and any other domestic currency-reservable liabilities and other demand and time deposits held with the RBM.

8. **Adjusters**. The ceiling on the stock of reserve money will be adjusted downward for a decrease in the reserve requirement ratio and the ceiling will be adjusted upward for an increase in the ratio, taking into account any change in the share of reserve assets which can be held with a discount house.[2] For each month of a particular quarter, the following calculation would be undertaken: [(1- the old percent of reserve assets which can be held at discount houses) **multiplied by** (the program baseline required reserve ratio) **minus** (1 – the new percent of reserve assets which can be held at a discount houses) **multiplied by** the new required reserve ratio] **multiplied by** the amount of reservable deposit liabilities in commercial banks as at the end of the previous calendar month. To determine the adjustment for a quarter, an average is calculated over the adjustment for each month in the quarter and the adjustment of the month preceding the quarter; in the calculation of the average, a weight of one third is given to both the adjustment in the first and second month in the quarter, and a weight of one sixth is given to both the adjustment in the last month in the quarter and the month preceding the quarter. The average is then applied to the target for the respective quarter.

B. Limit on Net Foreign Assets of the Monetary Authorities

9. A floor applies to the level of net foreign assets (NFA) of the monetary authorities. NFA will be valued in U.S. dollars at actual end-of-period exchange rates. Monetary gold will be valued at the fixed RBM accounting rate. NFA will be calculated as the difference between gross international reserve assets and international reserve liabilities.

10. **Gross international reserve assets** of the monetary authorities are defined as the sum of

- monetary gold holdings of the RBM;

[2] Currently, 25 percent of reserve assets can be held with discount houses.

- holdings of SDRs;
- Malawi's reserve position in the IMF;
- central government (treasury) holdings with crown agents; and
- foreign currency assets in convertible currencies held abroad that are under the direct and effective control of the RBM and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.
- Excluded from the definition of gross reserves are any foreign currency claims on residents, capital subscriptions in international institutions, assets in nonconvertible currencies, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

11. **International reserve liabilities** of the monetary authorities are defined as the sum of

- outstanding liabilities of the RBM to the IMF; and
- any foreign convertible currency liabilities of the RBM with an original maturity of up to and including one year.
- Excluded from the definition are liabilities arising from balance of payments support of original maturities of more than one year.

12. **Adjusters**. The floor on NFA will be adjusted upward, up to a maximum of US$50 million, for balance of payments support (including grants and loans) in excess of the programmed level as set out in the table on quantitative targets. The floor on NFA will be adjusted downward, up to a maximum of US$50 million, for balance of payments support (including grants and loans) falling short of the programmed level as set out in the table on quantitative targets.

13. **Balance of payments support** shall comprise all grant and loan external financing that is not automatically linked to additional budgetary expenditure. Project financing to fund particular activities is excluded from this definition, including food security funding from the European Union. Loan financing from the IMF is also excluded from the baseline balance of payments support. Given the large magnitudes involved, debt relief under the HIPC Initiative will be included in the projection of baseline balance of payments support.

IV. Limit on the Financing of the Central Government

14. A ceiling applies on the total financing flows of the central government (TFCG) which is measured cumulatively from December 31, 2001 for the end-June 2002 target; and

cumulatively from June 30, 2002 for the end-September 2002 and end-December 2002 targets.

15. **TFCG** is defined as the sum of the change in the stock of net credit from domestic banks and nonbanks, the change in domestic payment arrears, privatization proceeds from government assets that accrue to the central government, [3] the change in the net deposits in the account held with the Bank of Tokyo-Mitsubishi in Japan, external balance of payments support as defined in paragraph 13, and other external debt instruments as defined below **minus** amortization of external debt. Project loans and grants are not included in the financing definition.

16. **Net credit from domestic banks** is computed as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, and holdings of treasury bills minus deposits), (ii) net borrowing from commercial banks (including advances, holdings of local registered stocks and holdings of treasury bills minus deposits), and (iii) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost.

17. **Net credit from domestic nonbanks** includes (i) holdings of local registered stocks by the private sector and other financial institutions, (ii) holdings of Treasury bills by the private sector and other financial institutions, (iii) supplier credits, and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost.

18. **Domestic budgetary arrears** are defined as the net accumulation of new budgetary arrears during the current fiscal year.

19. New budgetary arrears are defined as those payments delayed on central government commitments during the current fiscal year, including on wages and salaries, pensions, transfers, domestic interest, goods and services, and payments to the Malawi Revenue Authority (MRA) for tax refunds. Payments on wages and salaries, pensions, and transfers are in arrears when they remain unpaid for more than 30 days beyond their due date.[4] Domestic interest payments are in arrears when the payment is not made on the due date. Payments for goods and services are deemed to be in arrears if they have not been made (i) within 30 days of the date of invoice, or—if a grace period has been agreed—(ii) within the contractually agreed grace period.

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[3] Some receipts from the privatization of parastatals have been split between the central government and the holding companies of the former parastatals. Only those receipts that accrue to the central government constitute financing of the central government.

[4] Pension benefits that are being assessed following retirement are not considered to be in arrears.

20. The **account held with the Bank of Tokyo-Mitsubishi in Japan** was set up for the delivery of Japanese debt relief. The net deposit in the account is calculated as the cash debt relief deposited by Japan[5] **minus** withdrawals from the account[6] valued at the end-month Yen-kwacha exchange rate.

21. The definition of **external debt instruments** is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85) August 24, 2000. For the purpose of this memorandum, "other external debt instruments" of paragraph 15 include in particular special loans such as external supplier credits and external holdings of promissory notes; excluded are external balance of payment loans; instruments to restructure, refinance, or prepay existing debts; and any kwacha- denominated treasury bill and local registered stock holdings by nonresidents.

22. **Amortization** of external debt is defined as amortization of project loans, balance of payment loans, and other external debt instruments.

23. **Adjusters.** The ceiling on TFCG will be adjusted downward for any transfer from the RBM to the central government and upward for promissory notes issued to cover RBM's operational losses in 2001.

V. Clearance of New Domestic Budgetary Arrears of the Central Government

24. Should at any time during the program new domestic budgetary arrears of the central government (as defined in paragraph 19 above) be verified, then the government will clear these arrears by no later than the end of the fiscal quarter following the fiscal quarter in which these arrears were accumulated.

VI. Limits on External Debt

A. Limit on Medium- and Long-Term External Debt

25. A ceiling applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf of the central government on debt with nonresidents with original maturities of over one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from December 31, 2001 for the end-June 2002 target; and cumulatively from June 30, 2002 for the end-September 2002 and end-December 2002 targets.

[5] Accounted for as a grant above the line.

[6] Accounted for as expenditure above the line.

26. The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979,[7] and as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85) August 24, 2000.

27. Excluded from the limit is the use of Fund resources; adjustment lending from the World Bank, the African Development Bank, and other multilateral agencies; debts to restructure, refinance, or prepay existing debts; concessional debts; and any kwacha-denominated treasury bill and local registered stock holdings by nonresidents.

28. For program 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 net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element is equal to nominal value minus NPV divided by nominal value). The NPV of debt at the time of its disbursement is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency-specific commercial interest reference rates (CIRRs), as published by the OECD. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculated the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program through December 2002, the CIRRs published by the OECD in May 2002 will be used (http://www.oecd.org/). For example, based on July 2000 CIRR rates, a U.S. dollar-denominated debt with a 10-year maturity would be considered concessional if the interest rate did not exceed 3 percent.

B. Limit on Short-Term External Debt

29. A ceiling applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf the central government of debt with nonresidents with original maturities of one year or less. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from December 31, 2001 for the end-June 2002 target; and cumulatively from June 30, 2002 for the end-September 2002 and end-December 2002 targets.

30. The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85) August 24, 2000.

31. Excluded from the limit are (i) debts classified as international reserve liabilities of the RBM; (ii) debts to restructure, refinance, or prepay existing debts; (iii) kwacha-denominated treasury bills and local registered stocks held by nonresidents; (iv) normal

[7] http://www.imf.org/external/pubs/ft/sd/index.asp?decision=6230-(79/140).

import financing; and (v) convertibility guarantees of the kwacha by the RBM. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VII. Limit on External Payment Arrears

32. A continuous target applies on the nonaccumulation of external payment arrears on external debt contracted or guaranteed by the central government or the RBM. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements.

VIII. Reporting Requirements for Technical Memorandum of Understanding

33. The authorities have committed themselves to using the best available data, so that any subsequent data revisions will not lead to a breach of a target. All revisions to data will be promptly reported to the Fund staff, particularly when the changes are significant. The likelihood of significant data changes will be communicated to Fund staff as soon as the risk becomes apparent to the authorities. All data will be reported electronically in the format and frequency set out below and within the period specified.

34. On a **weekly** basis within five working days of the end of the respective week, the balance sheet of the monetary authorities will be reported; and on a weekly basis (each Wednesday) with a two day lag, daily gross reserves, the daily US dollar to kwacha exchange rate, daily net interventions of the RBM in the foreign exchange market, daily reserve money, the daily net volume on open market operations, and the results of treasury bill and RBM bill auctions will be reported (reporting agency: RBM).

35. On a **monthly** basis within 30 working days of the end of the respective month, the monetary survey, the monetary authorities' accounts, the commercial banks' accounts, the international reserves position, local registered stock holdings, treasury bill holdings, interest rates, exchange rates, the consumer price index, guarantees extended by the RBM or central government on foreign operations of Malawian residents (reporting agency: RBM); and a consolidated table on total financing of the central government, including domestic and foreign financing will be reported (reporting agencies: RBM and Ministry of Finance).

36. On a **monthly** basis within 30 calendar days of the end of the respective month, the fiscal accounts of the central government, tables summarizing by line ministries achievement of commitment levels and arrears in the CCS3 and CCS4 returns, CCA, supplementary CCA, and reimbursement to commercial banks, and, within 45 days, a review summarizing the monthly reports by line ministries on commitment levels and arrears and assessing prospects for meeting budget targets will be reported (reporting agency: Ministry of Finance).

37. On a **monthly** basis within 30 calendar days of the end of the respective month, central government reports on spending on priority (poverty-related) programs (reporting agency: Ministry of Finance); and the revenue data and SGS import data will be reported (reporting agency: Malawi Revenue Authority (MRA).

38. On a **quarterly** basis within 45 calendar days of the end of the respective calendar quarter, the borrowings of the ten major parastatals (reporting agency: Ministry of Finance); a report on performance under the program (reporting agencies: RBM and Ministry of Finance); and a report on the verified expenditure arrears will be transmitted (reporting agency: Auditor General).

Malawi: Relations with the Fund
(As of May 31, 2002)

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

II. **General Resources Account**:	SDR million	%Quota
Quota	69.40	100.0
Fund holdings of currency	67.13	96.7
Reserve position in Fund	2.27	3.3

III. **SDR Department**:	SDR million	%Allocation
Net cumulative allocation	10.98	100.0
Holdings	0.46	4.2

IV. **Outstanding Purchases and Loans**:	SDR million	%Quota
Enhanced Structural Adjustment Facility (ESAF)/Poverty Reduction and Growth Facility (PRGF) arrangements	56.6	81.5

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	12/21/2000	12/20/2003	45.11	6.44
ESAF/PRGF	10/18/1995	12/16/1999	50.96	50.96
Stand-by arrangement	11/16/1994	06/30/1995	15.00	12.73

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	4/30/02	2002	2003	2004	2005	2006
Principal	0.0	4.4	7.2	9.2	10.2	9.2
Charges/Interest	0.0	0.4	0.5	0.5	0.4	0.4
Total	0.0	4.8	7.7	9.7	10.6	9.6

VII. Implementation of HIPC Initiative:

	Original framework	Enhanced framework	Total
Commitment of HIPC assistance			
Decision point date		12/21/00	
Assistance committed (NPV terms) [1]			
Total assistance (US$ million)		643	
Of which: Fund assistance (SDR million)		23.1	
Completion point date		Floating	
Delivery of Fund assistance (SDR million)			
Amount disbursed		2.3	2.3
Interim assistance		2.3	2.3
Completion point [2]		...	...
Amount applied against member's obligations (cumulative)		1.4	1.4

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the Reserve Bank of Malawi (RBM) is subject to a safeguards assessment with respect to the Poverty Reduction and Growth Facility Arrangement that was approved on December 21, 2000 and is scheduled to expire on December 20, 2003. A safeguards assessment of the RBM was completed on July 12, 2001. The assessment concluded that an on-site assessment was not needed at this stage, but proposed steps to address certain weaknesses in the areas of financial reporting and internal controls.

IX. Exchange Arrangements:

The exchange rate of the Malawi kwacha is market determined. The Reserve Bank of Malawi publishes a reference rate, based on interbank transactions, on a daily basis. The rate was US$1 = MK 75.9 on May 31, 2002.

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

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

X. **Article IV Consultation**:

Malawi is on the standard 12-month Article IV consultation cycle. The last Article IV consultation (EBS/00/263; 12/11/00) was concluded by the Executive Board on December 21, 2000.

XI. **Technical Assistance**:

Date	Duration	Dept.	Recipient	Purpose	Form
1/99	1 week	MAE	Reserve Bank	Monetary operations	Advisor
1/99	4 weeks	MAE	Reserve Bank	Banking supervision	Advisor
8/99	1½ weeks	MAE	Reserve Bank	Monetary operations	Mission
12/99	1½ weeks	FAD	Ministry of Finance	Expenditure control	Mission
12/99	2 weeks	FAD	Ministry of Finance	Improvement and extension of surtax	Mission
12/99	1 year	FAD	Ministry of Finance	Expenditure management	Advisor
01/00	1 year	STA	National Statistical Office	Statistics	Advisor
06/00	1 year	FAD	Ministry of Finance	Revenue administration	Advisor
11/00	2 weeks	FAD	Ministry of Finance	Improving fiscal data and commitment control	Mission
9/01	1½ weeks	FAD	Ministry of Finance	Expenditure tracking and fiscal ROSC	Mission
11/01	2 weeks	MAE	Reserve Bank	Monetary operations and further developing financial markets	Mission
02/02	2 weeks	FAD	Ministry of Finance	Expenditure policy	Mission
05/02	6 months	FAD	Ministry of Finance	Expenditure Management	Advisor
07/02	2 weeks	STA	National Statistical Office, RBM	GDDS	Mission

XII. **Resident Representatives**:

Mr. Girma Begashaw, since February 2002.

Malawi: Relations with the World Bank Group
(As of June 30, 2002)

1. The World Bank has been active in Malawi since 1966. The World Bank Executive Board has since approved 88 IDA credits and 10 IBRD loans. The World Bank's lending to Malawi to date totals US$2,136.7 million, of which US$1,931.0 million have been disbursed. This support has been allocated as follows: 17 percent for agriculture; 33 percent for structural and sectoral adjustment; 15 percent for infrastructure and water; 11 percent for education; 7 percent for energy; 4 percent for health; and the balance (14 percent) toward development finance, technical assistance, industry, urban housing, and institutional development.

2. Currently there are ten active projects in Malawi with a total commitment of $287.7 million, and an undisbursed balance of $136.2 million (as of April 1, 2001. The most recent major operation, approved by the Board on December 21, 2000, is the Third Fiscal Restructuring and Deregulation Program (FRDP III) for US$55.6 million (including IDA reflows of US$0.5 million). This operation was fully disbursed by end-January 2001. FRDP III is designed to support policy reforms, launched and supported by FRDP I and II since 1995, to improve public sector management, promote private sector growth, and strengthen the social safety net. A complementary technical assistance project for US$3.4 million was also approved which is geared toward helping Malawi implement policy reforms, especially in the area of procurement and financial management. Moreover, in fiscal year 2000, the Board approved the Privatization and Utility Reform Project ($28.9 million) which is designed to provide technical assistance for the government's privatization efforts.

3. Other important ongoing operations include: (i) the Malawi Social Action Fund II (approved in October 1998; US$ 66 million) which follows up on the first such fund, supporting safety net programs by creating temporary employment for the very poor and financing initiatives to assist the most vulnerable groups ;(ii) the Road Maintenance and Rehabilitation Project (June 1999; US$30 million) for strengthening the National Roads Authority, helping to increase capacity for rehabilitation and maintenance in local authorities, providing training for local contractors to take a larger share of road maintenance work, and financing some road rehabilitation; (iii) the Environment Management Project (June 1997; US$12.4 million) for improving the regulatory capability of the Ministry of Research and Environmental Affairs and promoting a shift in the responsibility for sustainable resource management to the community level; and (iv) the Secondary Education Project (March 1998; US$48 million) for expanding access to schooling by constructing secondary schools and improving educational quality by providing teaching and learning materials.

4. The IFC's equity participation and lending since the inception of its operations in Malawi amounts to US$31 million (gross) and includes nine investments in agribusiness, textiles, sugar, tourism, chemicals, plywood, a development finance corporation, and a leasing finance corporation. All credits have been fully disbursed. The current IFC

portfolio is relatively small, with US$3.5 million allocated to seven ventures. The World Bank's assistance strategy supports policy reform in areas of concern to the IFC, thus aiding its active search for investment opportunities in Malawi. Two loans have been approved and are awaiting commitment. One of these is for the establishment of the Continental Discount House (CDH), which is the first discount house in Malawi. The CDH will intermediate among financial institutions by trading and creating markets in bankers' acceptances, commercial paper, and treasury bills. The other involves the establishment of the first private–housing finance institution in the country. A possible area for future IFC involvement is the creation of a unit trust fund to broaden the ownership base of the economy and enhance domestic savings.

5. The IFC's Foreign Investment Advisory Service (FIAS) has assisted Malawi in designing its investment promotion strategy.

World Bank. Status of Active Projects as of April 1, 2002
(in millions of US$)

No	Project Name	Fiscal Year	IDA	GRANT	Undisb. Balances 1/
1	Environmental Management	1997	12.4		3.4
2	MASAF2	1999	66		25.3
3	Mulanje Mt. Biodiversity Conservation	2001		6.8	6.3
4	National Water Development	1995	79.2		12.1
5	Population/Family Planning	1999	5		2.6
6	Privatization and Utility Reform	2000	28.9		24.4
7	Road Maintenance	1999	30		14.6
8	Regional Trade Facility	2001	15		10.7
9	Secondary Education	1998	48.2		34.3
10	FRDP 3 TA	2001	3		2.5
	Total		287.7	6.8	136.2

Source: World Bank.
1/ Intended disbursements to date minus actual disbursements to date as projected at appraisal.

Malawi: Statistical Issues

1. The quality and timeliness of Malawi's economic statistics statistical data appears to be deteriorating, and substantial improvements are required in most areas. Malawi is one of fourteen countries participating in the Fund's General Data Dissemination System (GDDS) Project for Anglophone African countries. Malawi has undertaken to use the GDDS as a framework for the development of national statistical systems. GDDS metadata for Malawi is being finalized currently, and will be posted to the IMF's Dissemination Standards Bulletin Board in the near future. Malawi is benefiting already from technical assistance under the Anglophone Africa project (which is funded by the U.K. Department for International Development (DFID)) to implement plans for improvement identified in the metadata, to meet GDDS recommended statistical practices.

A. Real sector

2. Real sector statistics covering the national accounts, prices, and trade statistics need substantial improvements. Only a limited set of source data is available, and the quality and timeliness of the data need to be improved. Priorities include improvements in all aspects of the national accounts statistics and source data, updating the consumer basket of the consumer price index based on the 1997/98 household survey, and improvements in the quality and timeliness of the trade data.

National accounts

3. The National Statistics Office's (NSO) capacity to compile the historical national accounts data appears to have deteriorated, and there are substantial quality and source data problems. The NSO mainly relies on the production approach to compile estimates of the GDP, and problems with source data, in particular in agriculture, are exacerbating the NSO's difficulties in producing reliable data. In fact, grossly overestimated agricultural production statistics due to some flaws in the methodology, but also a likely overestimation by agricultural extension workers who had an incentives to overestimate data, directly contributed to the tragic consequences of the food crisis in early 2002. The responsibility for agricultural statistics have since been transferred to NSO, but given the agency's low capacity to gather, compile and produce national statistics, the problems may persist for some time. The NSO continues its efforts to revise recent national account estimates based on annual economic surveys and update the Business Information Register.

Prices

4. A consumer price index (CPI) is available on a timely basis, and price collection and imputation methods have recently been improved. However, the consumer basket is outdated

as NSO staff has so far been unable to revise weights based on the 1997/98 household survey, despite substantial training. The current index is based on the results of the Survey of Household Expenditure and Small-Scale Economic Activities conducted from July 1990 to June 1991 by the NSO. Indices are computed separately for low-, medium-, and high-income households in each of four major urban areas. In addition, a rural areas index is compiled from information on six predominantly rural markets or trading centers in three different regions of the country.

Trade

5. The lag in the provision of preliminary estimates of trade data has recently increased to 10-12 months, and of final trade data to about 1½ years. Low capacity handling in the software systems is hampering the efforts to improve the timing and quality of data. The electronic data processing system has been updated, and the NSO is working on clearing the backlog.

Other real sector statistics

6. The industrial production index is based on a survey of 50 of the larger firms, selected and weighted according to surveys conducted in 1984. The manufacturing output figures in the national accounts show different growth rates from the index of manufacturing production, partly because the national accounts include estimates for medium-scale production.

B. Government Finance

7. Malawi has not reported for some time government finance data for inclusion in the *Government Finance Statistics Yearbook (GFSY)* and in *International Financial Statistics (IFS)*. At present, data on the central government provided by the authorities for publication extend only through 1990.

8. There are substantial quality problems, including data inconsistencies, that complicate program monitoring:

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

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

- Expenditure on domestically-financed **development expenditure** is reported based on funding released to line ministries, whereas data on externally funded expenditure is based on disbursed project grants and loans. Owing to differences in financing modalities (e.g., some donors require prefinancing of expenditure before reimbursement), there are likely to be differences between the flow of expenditure and financing data. Some donor projects are also not incorporated in the budget.

- Although the reporting on **expenditure arrears** has improved, there is still uncertainty regarding the data, including arrears on utility payments and related netting operations.

- There are also concerns about the **financing data**, particularly the quality and consistency of the external debt service, supplier credits, and domestic debt data.

9. Considerable efforts has been devoted to improving the fiscal data. In addition to previous technical assistance, the AFR mission in April-May 2002 organized a full-day workshop with staff from the RBM and the Ministry of Finance focusing on the major data problems. The FAD fiscal advisor, that has recently been assigned to the Ministry of Finance, will also provide support to the authorities in improving the data quality.

C. Monetary Accounts

10. Monetary statistics are generally in line with international standards. However, until January 2001 data for the deposit money banks covered only two of the seven commercial banks (these two banks account for about 85 percent of the banking sector). Since then, the Reserve Bank of Malawi (RBM) has extended the statistics to cover two other banks and provides now two separate sets of monetary statistics for two banks (the largest two) and four banks, respectively. Developments in the broader money aggregate for the four banks have been broadly in line with those in the aggregate for the two banks. The program will continue to use the statistics covering the largest two banks until the RBM can provide assurances that data on all four banks can be delivered in a timely manner.

11. The authorities report monetary data for publication in IFS on a regular basis, albeit

with some delays. The latest data in the current issue of IFS refer to December 2001, and the deposit money banks data cover the accounts of two commercial banks.

D. Balance of Payments

12. No balance of payments data are available in *IFS* since 1994. Mainly as a result of the liberalization of exchange controls, the compilation of data relies on balance of payments surveys as the major available source of reliable information for major components in the balance of payments, such as services, direct investment flows, and other financial transactions of the private sector. Direct investment data is available from the Malawi Investment Promotion Authority (MIPA). However, not all foreign direct investment is captured by MIPA, the NSO will therefore soon be starting to conduct a survey of foreign investment in Malawi. Portfolio investment data are collected by the Malawi Stock Exchange. Also, a register of companies with likely balance of payments transactions is being compiled for a revamped balance of payments survey.

E. Organizational Measures

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

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

Malawi: Survey of Reporting of Main Statistical Indicators
(As of July 11, 2002)

	Exchange Rates	International Reserves	Reserve Money	Central Bank Balance Sheet	Broad Money	Treasury and RBM Bill Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt Service
Date of latest observation	7/10	7/10	7/9	6/21	5/31	7/9	5/31	12/01	2001	5/31	2001	04/30
Date received	7/11	7/11	7/10	7/7	6/28	7/10	6/20	5/10	05/10	6/28	05/10	05/10
Frequency of data[1]	D	W	D	W	M	W	M	M	A	M	A	M
Frequency of reporting data[1]	D	W	W	W	M	W	M	Q	Q	M	A	Mission
Source of data[2]	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting[3]	M	M	M	M	C	M	C	C	C	C	C	Mission
Confidentiality[4]	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of publication[1]	M	M	M	M	M	W	M	A	A	A	A	...

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

Malawi: Selected Social and Demographic Indicators 1/

	Malawi	Sub-Saharan Africa
Area (thousand sq. km.)	94	23,603
Poverty and inequality		
Population below the poverty line (percent)	65	...
Per capita income ($ US)	170	470
Labor force		
Total participation rate (percent)	51	...
Percent employed in agriculture	54	...
Percent in industry	22	...
Education		
Gross enrollment rates (percent)		
Primary	134	78
Secondary	17	26
Tertiary	1	4
Illiteracy rate (percent of people aged 15 and above)		
Total	40	39
Men	26	30
Women	53	47
Population characteristics		
Total population (millions)	10.3	658.9
Annual rate of growth (percent 1993-1999)	2.1	2.4
Population density (per sq. km.)	110	28
Urban population (percent of total)	15	34
Health		
Life expectancy at birth (years)	39	47
Infant mortality (per 1,000 live births)	132	91
Under 5 years mortality (per 1,000)	193	162
Maternal mortality (per 100,000 live births)	1,120	1,100
Child immunization rate (under 12 months; percent)	80	50
Child malnutrition (under five years)		
Percent underweight	30	
Percent stunted	48	
HIV/AIDS prevalence rate (percent)	15	8.4
Access to safe water		
Percent of total population	65	55
Urban population	95	...
Rural population	61	...

Sources: World Bank, *World Development Indicators 2001* as of March 31, 2002; and National Statistical Office of Malawi, *2000 Malawi Demographic and Health Survey Report*.
1/ Data for most recent year available.

INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the 2002 Article IV Consultation and Economic Program for 2002 Supplementary Information

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by Michael Nowak and Masood Ahmed

July 29, 2002

1. This supplement to EBS/02/131 (7/22/02) provides new information on the food security situation since the staff report was issued. The update does not alter the thrust of the staff appraisal.

2. **The latest assessment of Malawi's food situation in 2002/03 suggests that the food shortage might be more severe than previously thought.** The staff report indicated that, at end-May 2002, the Food and Agriculture Organization (FAO)/World Food Program (WFP) had projected a shortfall of 485,000 metric tons for August 2002-March 2003. Recently, however, the Ministry of Agriculture and Irrigation, together with the USAID's Famine Early Warning System, revised upward the estimate of the food shortage by about 100,000 metric tons.

3. **Thus, the authorities are now considering stepping up their food imports, as needed, to 350,000 metric tons (equivalent to about US$97 million) from the 250,000 metric tons reported in the staff report.** These additional imports would have an

Selected Economic Indicators, 2002-03

	2002		2003	
	EBS/02/131	Rev. proj.	EBS/02/131	Rev. proj.
External current account after grants (in percent of GDP)	-11.3	-12.7	-6.7	-6.7
Imports (in millions of U.S. dollars)	768.2	795.9	657.2	657.2
Balance of payments gap (in millions of U.S. dollars)	...	...	60.0	88.2
International reserves (at year's end; in millions of U.S. dollars)				
gross	129.9	102.1	228.4	228.4
(in months of imports)	2.1	1.6	3.4	3.4
net	56.0	28.3	148.9	148.9
Domestic fiscal balance (in percent of GDP) 1/	-5.4	-6.0	-3.2	-3.2

Sources: Malawian authorities; and staff estimates and projections.

1/ Fiscal year. For 2002, fiscal year 2002/03.

impact on the macroeconomic program presented in the report. In particular, international reserves could fall to below one month of import coverage in November 2002, while the fiscal deficit in 2002/03 could widen to 6 percent of GDP (compared with the previous target of 5½ percent), reflecting the effect of the extension of the price subsidy on the additional food imports. For 2003, the projected balance of payments gap could widen to about US$90 million from US$60 million.

4. **The authorities and the staff are concerned that financing the increased food imports with international reserves would reduce reserves to a level that would not provide sufficient protection against unforeseen shocks and could derail the macroeconomic program.** At a minimum, international reserves should remain at the level envisaged in the staff report to lend credibility to the macroeconomic stabilization strategy, as otherwise there would be a considerable risk that dwindling reserves could trigger ad hoc policy adjustments. Moreover, given the still significant uncertainty with regard to the estimate of the food shortage,[1] a level of international reserves higher than projected in the staff report might be desirable so as to give the authorities the flexibility to import additional food should the need arise.

5. **Consideration is, therefore, being given to providing Malawi with emergency assistance[2] in an amount of 25 percent of quota (about SDR 17 million); the World Bank staff is also contemplating support under an emergency recovery loan.** Prompt action by the Fund and the World Bank would likely catalyze additional donor support.

6. **The staff intends to present a formal request by the authorities for emergency assistance to the Board shortly, for approval on a lapse-of-time basis.**

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[1] The agricultural production statistics on which these estimates rely have been flawed in the past and remain unreliable. Improving the quality of statistics is likely to take considerable time.

[2] Purchases under emergency assistance are subject to the General Resources Account (GRA) rate of charge, currently at 3 percent, compared with 0.5 percent for PRGF resources, and a repayment period of 3¼ to 5 years. After replenishing reserves at end-2002, including through, possibly augmented, access under the PRGF at the time of the first review, Malawi would be able to make an early repurchase of the emergency assistance resources.

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Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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700 19th Street, NW
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IMF Concludes 2002 Article IV Consultation with Malawi

On August 5, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Malawi.[1]

Background

Malawi has experienced a severe food crisis in early 2002, resulting in wide-spread malnutrition and starvation as early warning systems, which are an integral part of the government's food policy, failed. While the acute shortage has been temporarily alleviated by the new harvest, an even larger food shortage is expected for later in the year and the beginning of 2003, and the government and the donor community are in the process of fleshing out an appropriate response.

Economic activity has been stagnating. Real output is likely to have contracted in 2001 and, at best, a weak recovery is expected for 2002. This is mostly attributable to depressed agricultural output owing to a drop in the maize production both in 2001 and 2002. At the same time, high real interest rates have been encumbering private sector activity—growth in the manufacturing and services sectors remained negligible and industrial activity shrank to its lowest level in more than a decade.

Since end-2000, inflation fell considerably, but real interest rates have remained high. The headline 12-month inflation declined to below 17 percent in June 2002, from 35 percent in December 2000 as, for the most part since December 2000, the Reserve Bank of Malawi has

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

followed a tight monetary stance. But real interest rates remain high at over 30 percent, reflecting an expansionary fiscal policy, but also persistent inflation expectations in light of a history of stop-and-go disinflation episodes. After the large real depreciation during 2000, the kwacha appreciated in real effective terms during 2001 correcting for the development in 2000, but reflecting also the fiscal expansion and, later in the year, the depreciation of the South African Rand.

Fiscal policy has been expansionary until the beginning of 2002, crowding out the private sector. Slippages from the program came mostly from policy decisions to bail out parastatals, augment civil servants' wages, increase other low-priority public spending, such as travel and representation, and reduce income taxes. These slippages were exacerbated by a rising interest bill and weak revenue collections due to a decline in firms' profitability and sluggish collection of import-related taxes.

However, expenditure appears to have been contained since March 2002 and the 2002/03 (July to June) budget targets a decisive adjustment in the domestic balance to 6 percent of GDP from an estimated 8 percent of GDP in 2001/02. While this adjustment will require tax measures and substantial cuts in nonpriority spending, this accommodates a subsidy for maize and an increase in spending on priority pro-poor programs to almost 6 percent of GDP from about 5 percent of GDP in 2001/02 and 3½ percent of GDP in 2000/01.

The external current account deficit narrowed to 13 percent of GDP in 2001, down from some 14 percent in 2000. A small deterioration in the trade balance was more than offset by an improvement in the services balance. The current account deficit is expected to widen substantially in 2002, due to food imports. Despite the suspension of balance of payments support by most donors at end-2001, international reserves remained adequate and stood at about 3 months of imports at end-June 2002.

While public expenditure management has been strengthened, progress in implementing reforms with respect to parastatals have gained momentum only recently with the large bailouts highlighting the need for action. The Ministry of Finance has now more control over parastatals' finances and audits of the large agriculture marketing parastatal and its subsidiaries have been completed. After a temporary suspension of the privatization program in mid-2001, the authorities have privatized the Commercial Bank of Malawi in December 2001 and are in the process of completing the privatization of other major parastatals.

The authorities have finalized a Poverty Reduction Strategy Paper (PRSP) at end-April 2002 which emanated from a highly participatory process. Its strategy relies on a framework consistent with achieving the macroeconomic objectives of the program and presents a balanced approach to create the necessary conditions to generate growth, improve social sector outcomes, protect the vulnerable, and improve governance.

Executive Board Assessment

Directors expressed concern over Malawi's impending food shortage, and welcomed the pledges for humanitarian aid by the international community. Directors welcomed the recent call to donor nations by the Managing Director and the President of the World Bank to commit food aid to Southern Africa.

Noting that humanitarian aid would be insufficient to avert widespread malnutrition and starvation, Directors endorsed the authorities' intention to import food and provide it at a subsidized price. In this setting, they generally welcomed the imminent request from Malawi for emergency assistance from the Fund to facilitate food imports without depleting the Reserve Bank of Malawi's (RBM) international reserves to levels that would no longer provide protection against unforeseen shocks. However, Directors stressed in this connection the importance of proceeding with planned reforms and more broadly the need to identify and implement policies that would help safeguard against these risks in the future.

Directors considered that Malawi has made some progress in restoring macroeconomic stability but that, reflecting severe slippages in past program implementation, overall performance under the Poverty Reduction and Growth Facility (PRGF) arrangement had been disappointing. Inflation has been reduced, but growth remains elusive; real interest rates are high, as a result of overly expansionary fiscal policies; and inflationary expectations are ingrained.

Directors welcomed the renewed commitment of the authorities to bring the program back on track and establish a record of performance, so that the first review under the PRGF arrangement could be completed by year-end. They considered that the inflation target for 2002 is well within reach, and that the decisive turnaround in fiscal policy to which the government is now committed will lead to the needed substantial reduction in interest rates and faster economic growth.

Directors stressed that the success of the program would hinge critically on high-level commitment to fiscal restraint—among other things, because of unduly expansionary fiscal policy crowding out private sector investment. Directors therefore welcomed the decisive fiscal adjustment envisaged in the 2002/03 budget, which will halt the increase in public debt and create an environment conducive to private sector-led growth. Directors also praised the reorientation of the budget toward pro-poor spending, facilitated by cuts in nonpriority programs. At the same time, the authorities should guard against any surge in expenditure arising in the run-up to the elections in 2004.

Directors welcomed the progress made in strengthening expenditure management, and were encouraged by the authorities' commitment to track, monitor, and publicize performance in the execution of pro-poor spending. However, as recommended in the report of the Review of Standards and Codes on fiscal transparency, further steps were needed to make the expenditure system a more effective short- and medium-term tool of fiscal control, and to prevent the past large overruns in nonpriority programs.

Directors considered that Malawi's current flexible exchange rate policy continues to serve the economy well. They emphasized that tight monetary policy must be sustained to attain the inflation objective: while inflation has been declining, the authorities should observe the reserve money target and stand ready to tighten the policy stance, if inflationary pressures reemerge.

Directors welcomed the finalization of the poverty reduction strategy paper (PRSP), which contains a sound framework for reducing poverty and creating an enabling environment for private sector-led growth. The PRSP was prepared in a highly participatory process. It represents a balanced approach to public policy which, if fully and effectively implemented, should create the necessary conditions for growth, improve social sector outcomes, protect the vulnerable, and provide an institutional structure for monitoring progress in reaching poverty reduction goals. Given the critical role of gender issues in poverty reduction, Directors encouraged the authorities to take the gender dimension of policies fully into account in implementing the PRSP. Directors also stressed that the PRSP's priorities need to be properly costed and included in the short- and medium-term budgetary framework.

Directors urged the authorities to develop a coherent agricultural policy that would make agriculture the engine for medium-term growth—and directly address the prevalence of poverty in Malawi among the rural and subsistence farming population. A more thorough analysis of the impact of the HIV/AIDS pandemic on Malawi's growth strategy is also needed.

Directors urged the authorities to make parastatal operations more transparent, and to differentiate clearly between the government mandates and commercial activities of these enterprises, in particular those connected with agricultural marketing and the grain reserve.

They encouraged the authorities to follow through swiftly with their privatization and commercialization agenda. They welcomed the recent privatization of the Commercial Bank of Malawi, and the plans to complete the privatization of Malawi Telecom and Air Malawi. Together with privatization in all sectors, it would be crucial to ensure competitive market structures, and nowhere is this more important than in agriculture.

Directors welcomed the strengthening of the legal framework for addressing corruption and building the capacity of the investigative authorities and the judiciary. They stressed, however, that commitment to implementation is crucial, and that Malawi's anti-corruption campaign would gain credibility from bringing to closure high-profile cases.

Directors noted with concern the deterioration of macroeconomic statistics in the last few years. They urged the authorities to step up their efforts to address long-standing deficiencies and reduce delays in the provision of statistics. Recognizing the country's capacity constraints in this area, Directors called for international and multilateral technical assistance support.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with Malawi is also available.

Malawi: Selected Economic and Financial Indicators, 1999-2001

	1999	2000	2001 Prel.
	(Percentage change, unless otherwise indicated)		
GDP and prices			
GDP at constant market prices	4.0	1.7	-1.5
Per capita GDP (in U.S. dollars)	179.3	165.5	166.2
Consumer prices (end of period)	28.2	35.4	22.1
GDP deflator	42.2	25.2	26.1
Money and credit 1/			
Money and quasi money	33.6	42.4	12.1
Net foreign assets	11.5	46.8	-15.1
Net domestic assets	22.1	-4.4	27.2
Credit to the government	-2.9	6.9	33.7
Credit to the rest of the economy	20.6	12.4	-5.1
	(Percent of GDP, unless otherwise indicated)		
Central government 2/			
Revenue (excluding grants)	17.4	18.3	16.8
Expenditure	30.0	33.3	32.7
Domestic primary balance (cash mod. basis) 3/ 4/	-0.4	-1.7	-3.7
Domestic balance (cash mod. basis) 4/	-2.7	-4.7	-8.1
Overall balance (cash mod. basis, including grants) 4/	-5.6	-5.8	-8.9
Savings and investment			
Domestic saving	-0.3	0.5	-1.0
National saving	6.5	7.3	3.6
Foreign saving 5/	16.9	13.9	12.9
Gross investment	14.8	12.5	10.9
External sector			
Exports f.o.b.	24.7	23.8	23.3
Imports c.i.f.	37.2	33.0	33.3
External current account (including official transfers)	-8.3	-5.3	-7.3
External debt	144.1	156.7	156.4
Debt-service ratio 6/	17.7	21.8	21.1
Terms of trade	62.3	58.4	58.8
Kwacha per U.S. dollar exchange rate (per. avg.)	44.1	59.5	72.2
Gross official reserves			
End-period stock	244.2	242.2	201.8
In months of imports of goods and nonfactor services 7/	4.5	4.4	2.8
External debt (disbursed and outstanding, end of period)	2,608	2,674	2,736

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

1/ Change in percent of money and quasi money at the beginning of the period.
2/ Fiscal year starting July 1; information for 2001 refers to fiscal year 2001/02 etc.
3/ Excludes grants, domestic and foreign interest, and foreign-financed development expenditure.
4/ Cash-modified basis defined as cash spending and expenditure in arrears.
5/ External current account, excluding official transfers.
6/ In percent of exports of goods and nonfactor services. Excludes debt relief.
7/ In percent of imports of goods and nonfactor services in the following period.