August 2005
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Malawi: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Additional Interim Assistance Under the Enhanced Initiative for Heavily Indebted Poor Countries—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Malawi

In the context of the request for a three-year arrangement under the Poverty Reduction and Growth Facility and additional interim assistance under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC) for Malawi, the following documents have been released and are included in this package:

- the staff report for the request for a three-year arrangement under the Poverty Reduction and Growth Facility and additional interim assistance under the enhanced HIPC Initiative, prepared by a staff team of the IMF, following discussions that ended on April 29, 2005, 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 22, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of August 5, 2005 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its August 5, 2005 discussion of the staff report that completed the request.

- a statement by the Executive Director for Malawi.

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

Joint Staff Advisory Note of the Poverty Reduction Strategy Paper—Annual Progress Report
Letter of Intent sent to the IMF by the authorities of Malawi*
Memorandum of Economic and Financial Policies by the authorities of Malawi*
Poverty Reduction Strategy Paper—Annual Progress Report
Technical Memorandum of Understanding*
*May also be included in Staff Report

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

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INTERNATIONAL MONETARY FUND

MALAWI

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility (PRGF) and Additional Interim Assistance Under the Enhanced HIPC Initiative

Prepared by the African Department
(In consultation with other departments)

Approved by Michael Nowak and Matthew Fisher

July 22, 2005

- **Discussions.** A staff team visited Lilongwe during February 17–March 3 and April 19-29, 2005, to discuss performance under the staff-monitored program (SMP) and an economic program for 2005-08 to be supported under a new PRGF arrangement. The staff held discussions with President Bingu wa Mutharika; Minister of Finance Goodall Gondwe; Governor of the Reserve Bank Victor Mbewe and former Governor Ellias Ngalande; and other senior officials of the government. The staff coordinated closely with donors and met with NGOs and business representatives.

- **2000 PRGF arrangement and SMP.** Malawi's last PRGF arrangement was approved in December 2000 (SDR 45.11 million, 65 percent of quota) and expired in December 2004 after only one review was completed. The authorities subsequently requested an SMP covering July 2004–June 2005 to build a performance track record. Performance under the SMP to date has been satisfactory.

- **New PRGF arrangement.** The authorities are requesting a three-year PRGF arrangement (SDR 38.17 million, 55 percent of quota) to support their program. They have prepared a second annual progress report on the implementation of their poverty reduction strategy, which also sets out the medium-term framework that serves as a basis for the PRGF-supported program. The Annual Progress Report was issued to the Boards of the Fund and the World Bank in June. The main findings of the Ex Post Assessment of the Funds involvement in Malawi (EPA), the importance of strong policy implementation and realistic macroeconomic and structural objectives, have been incorporated into the PRGF-supported program.

- **Objectives of the program.** The overarching medium-term objective will be to reduce poverty through private sector-led growth. Macroeconomic stability continues to be the main near-term objective. Fiscal restraint will be crucial to avoid adverse debt dynamics and ensure that the government can provide critical services.

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Executive Summary

Malawi's economy improved during 2004, but prospects for 2005 have been adversely affected by a prolonged dry spell during the growing season. The dry spell mostly affected the maize harvest, Malawi's food staple, and will require sound economic management, supported by substantial donor assistance and fiscal resources.

Performance under the SMP has been satisfactory. This is in marked contrast to the weak policy implementation from 2001 to mid-2004. This demonstrates a renewed commitment by the authorities, and also the formulation of more realistic program objectives as called for in the EPA.

Fiscal latitude in the past has left the country with a high domestic debt burden. This is consuming a large share of government resources and diverting resources from private investment. Moreover, key aspects of the economic infrastructure have deteriorated and pushed up the cost of doing business. Fiscal policy will aim to reduce the government's domestic debt, while allowing for increases in pro-poor and pro-growth spending. The 2005/06 budget framework envisages a large repayment of domestic debt, but also spending increases for health care and education and other pro-poor spending.

Monetary policy will aim to bring down inflation to the 5–8 percent range by 2008. Sufficient resources will be available for private sector credit. Because Malawi is vulnerable to external shocks and adverse weather conditions, the authorities' medium-term framework targets a rebuilding of international reserves.

The structural reform agenda reflects the government's vision for a more efficient public sector and for growth led by the private sector. Consequently, the program focuses on tax and civil service reform, steps to reduce financial intermediation costs, and improvements in economic infrastructure.

Policy implementation will require a sustained commitment at the highest political levels. Predictable donor inflows will help support good policy performance. Program implementation also remains vulnerable to exogenous shocks due to the lack of economic diversification.

As in the past, program performance faces risks from weak policy implementation, poor weather conditions, and volatile donor support.

In light of Malawi's recent satisfactory performance under the SMP and the authorities' commitment to macroeconomic stability, the staff recommends the approval of the authorities request for a three-year PRGF arrangement and additional HIPC interim assistance. It also recommends that access reflect the balance of payments needs arising from the maize shortfall.

I. Background

1. **Malawi is one of the poorest countries in Africa.** Two-thirds of the population live in poverty; the incidence of malaria is very high; and approximately 15 percent of the adult population is infected with HIV. Significant progress toward the millennium development goals (MDGs) will require sustained aid inflows.

2. **Malawi's economic performance under the last PRGF arrangement was disappointing.** Weak governance and program implementation led to an unstable macroeconomic situation characterized by large fiscal slippages, an unsustainable domestic debt spiral, and low domestic investment. Despite multiple attempts to bring the program back on track, stabilization was not attained, and the arrangement was allowed to lapse after completing only one review. Therefore, in mid-2004, the newly elected government asked Fund staff to monitor its program in order to establish a track record that could lead to a new PRGF arrangement.

3. **In concluding the 2004 Article IV consultation (October 2004), Directors commended the new government's ownership of the program and actions to address corruption at the highest levels.** They agreed with the conclusions reached by the EPA that inadequate ownership and weak institutions were key factors behind the record of poor program implementation and emphasized the importance of adhering to the 2004/05 budget. Performance to date under the SMP demonstrates the benefits of program ownership.

4. **The HIPC completion point could be reached by mid-2006, if outstanding triggers are implemented**. The authorities finalized the annual progress report (APR) on the implementation of their poverty reduction strategy (PRS) during 2003/04 in early 2005 and submitted it to the IMF Executive Board in June. Malawi reached the decision point under the enhanced HIPC initiative in December 2000 and its PRS was endorsed by the World Bank and IMF Boards in August 2002.

5. **In the attached letter to the Managing Director (Appendix I), the government of Malawi requests a three-year PRGF arrangement in support of its medium-term policies in the amount of SDR 38.17 million (55 percent of the quota).** The requested amount includes about SDR 7 million (10 percent of quota) to address the 2005 food emergency. The authorities also request SDR 4.628 million in additional interim assistance from the IMF under the HIPC Initiative to be applied in broadly equal amounts in the remainder of 2005 and the first half of 2006. The accompanying memorandum of economic and financial policies (MEFP) reviews Malawi's policy implementation under the SMP and discusses macroeconomic and structural policies to be implemented during July 2005-June 2008. The overarching objective of the authorities' medium-term program is to reduce poverty by fostering an environment that is favorable to private sector led growth. In view of the level of resources needed to reduce poverty and promote growth, Malawi will continue to rely on donor support. The authorities' program is in line with Malawi's poverty reduction strategy (MPRSP), the EPA's recommendations, and the experience gained in implementing the SMP.

6. Parliament approved the 2005/06 budget on July 15. President Mutharika left the United Democratic Front (UDF) party in early 2005 and formed the Democratic Progressive Party (DPP). The government does not have a formal majority in parliament and has been relying on opposition parties and independent members for support. The first weeks of the budget sitting were marked by disagreement, including calls for the impeachment of the president; there was eventual agreement on pushing ahead with consideration of the budget.

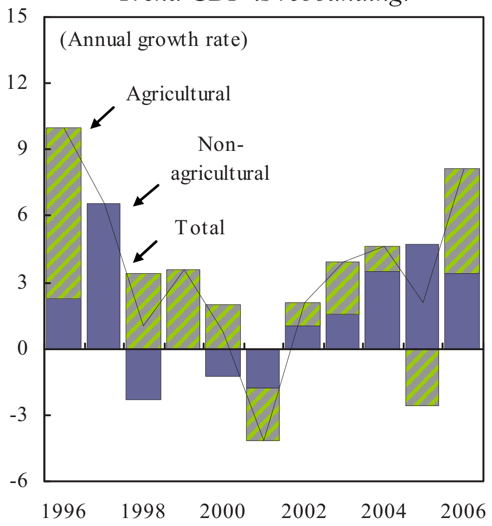
II. Recent Developments and Performance Under the SMP

7. **Malawi's economy improved during 2004, but, unfortunately, prospects for 2005 have been affected by the dry spell in early 2005 (Tables 1-4)**:

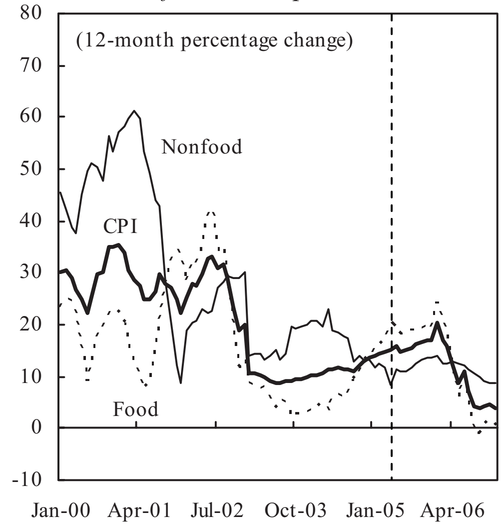
- **Real GDP growth** rose from less than 4 percent in 2003 to 4½ percent in 2004, on account of a rebound in tobacco production. However, the drought in early 2005 is estimated to have cut the harvest of Malawi's food staple, maize, by about 25 percent, causing a potential humanitarian crisis, in addition to dampening overall economic growth prospects to about 2 percent this year.

- **Core (nonfood) inflation fell to 13¼ percent at end-2004, from over 20 percent at end-2003**. Food price inflation rose over the period, causing an increase in overall consumer price inflation. The early 2005 drought is expected to push food prices up temporarily later in the year and the depreciation of the kwacha is expected to be partially passed through to nonfood prices.

Trend GDP is rebounding.

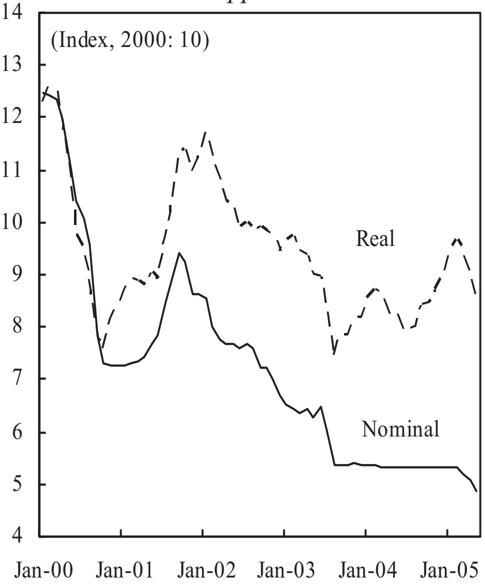


Trend inflation is expected to decline.

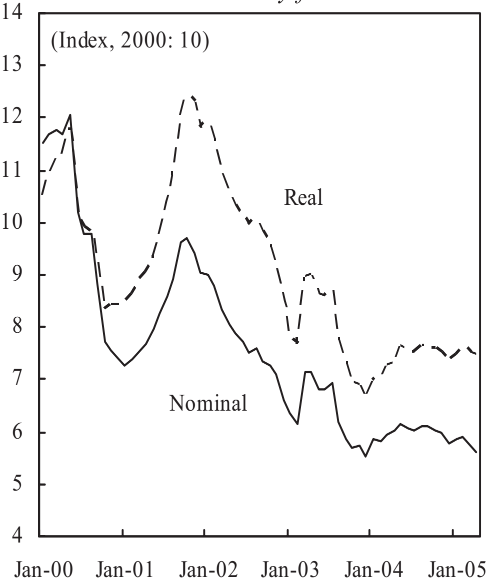


- **The kwacha–U.S. dollar exchange rate remained largely unchanged from August 2003 through mid-March 2005.** During early 2005, the RBM put in place informal administrative procedures to tightly manage the exchange rate and safeguard resources for the possible food crisis. [1] By early March this resulted in a backlog of foreign exchange invoices at commercial banks, and a decision by the RBM to allow

The real exchange rate vis-a-vis the dollar appreciated...



...while the real effective exchange rate was broadly flat.



the currency to depreciate against the U.S. dollar. The informal administrative restrictions were subsequently discontinued in mid-March (para. 35). This action and the seasonal pickup in tobacco sales resulted in a significant reduction in unpaid foreign exchange invoices. The remaining invoices reflect delays in the commercial banks related to normal business practices and not central bank restrictions. These will be explored further during the first review of the PRGF.

The real effective exchange rate, however, was relatively stable during most of this period as the appreciation of the rand and euro against the kwacha mostly offset higher inflation in Malawi.

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[1] To avoid the currency overshooting ahead of the 2005 tobacco sales, the RBM asked foreign currency dealers to purchase foreign exchange at the official RBM rate. This put a floor under the kwacha. Normally, the dealers trade the kwacha within two percent of the official RBM rate, which is set at the average of the previous day's market rates. This procedure limits day-to-day volatility only.

- **The external current account deficit (excluding grants) in 2004 worsened to** 19 percent of GDP from 17 percent in 2003. Despite higher tobacco production, export performance did not improve, due to temporary processing difficulties. The import bill rose in response to stronger domestic demand and higher oil prices. Usable gross reserves at end-2004 were US$119 million and 1.3 months of imports, little changed from end-2003, although coverage fell to one month at end-March 2005 as a result of delays in budget support.

- **Anticorruption efforts are moving ahead.** Several former government officials and one minister in the current cabinet were arrested or are being investigated.

- **The Reserve Bank of Malawi (RBM) closed a commercial bank for repeated violations of foreign exchange reporting requirements in late May 2005**. The bank was reopened shortly afterward under RBM supervision.

8. **Performance under the SMP was satisfactory through March 2005** (Tables 5a and 5b). Virtually all quantitative targets were observed, and implementation of structural reforms has improved markedly. This turnaround in policy implementation demonstrates a renewed commitment by the authorities, and also reflects the formulation of more realistic program objectives as suggested by the EPA of the Fund's involvement in Malawi.

Malawi: Central Government operations 2004/05
(In percent of GDP)

	SMP			Current		
	QI-III	QIV	FY	QI-III	QIV	FY
Total revenue and grants	26.3	9.4	35.7	25.5	13.3	38.8
Of which: domestic revenue	17.6	6.4	24.0	18.4	6.5	24.8
Total expenditure	30.4	9.5	40.0	29.2	13.7	42.9
Of which:						
Wages and salaries	5.2	1.9	7.1	5.5	2.2	7.7
Interest payments	6.8	2.2	9.0	6.8	1.9	8.7
Other current expenditures	12.3	2.9	15.1	11.6	4.1	15.8

- **Discretionary expenditures** were within the ceilings established in August 2004, reflecting the government's commitment to adhere to the approved budget. Cost saving measures included the move of the president's residence to Lilongwe; the reduction in number of ministers; the reduction of more than 100 senior staff positions; and the elimination of the special activities budget that was the source of past overruns.[2] Expenditures for the Targeted Input Program (TIP), providing fertilizer subsidies, were above target for the program period.

- **The civil service wage bill** exceeded expectations because the wage reform package implemented in October 2004 proved more costly than initially estimated (Box 1). The government has moved to contain the overrun and to address inefficiencies and inequities that became apparent under the new system.

Box 1. Malawi: Impact of 2004 Civil Service Wage Reform

Implementation of the civil service wage reform constitutes a significant improvement in transparency. The numerous allowances that were not taxed (e.g., fuel and housing) were consolidated into basic pay, pay grades were unified across the core civil service, and the number of grades was reduced to 18 from 75. Moreover, the pay line was realigned and partly decompressed. As a result of the reform, general gross wages rose by 25 percent, the minimum wage increased by 50 percent, pay to upper-level professionals increased, and pay to top-tier contractuals was frozen.

The cost of the reform was sizable. Incomplete and inaccurate information at the time the reform was planned, resulted in an overrun of about 1½ percent of GDP a year. In addition, employees were reassigned to the entry-level pay point of their grade, eliminating seniority and skill wage differentiation within pay grades. This will need to be addressed in the years ahead.

The authorities intend to keep the domestically financed wage bill within MK 20 billion in 2005/06. This ceiling will allow the authorities to increase the minimum wage in the second quarter of the fiscal year, at the time the civil service promotions are announced. The authorities have committed to capping the wage bill at 8 percent of GDP or less over the medium term. The cap excludes pay increases for health care professionals that are funded under the health SWAP.

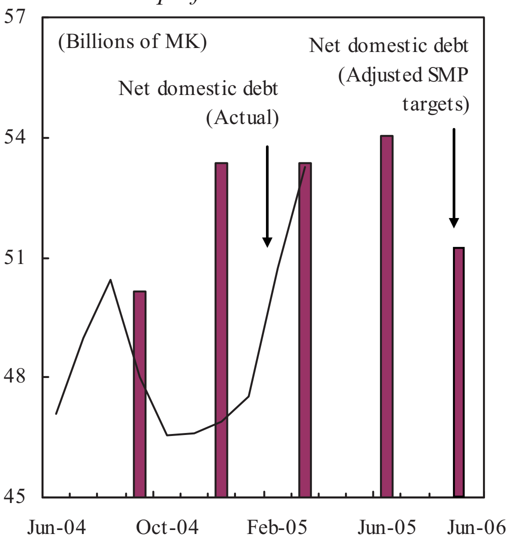
The reform also affected pension benefits, and the authorities have committed to actions to contain this cost. In particular, the formula on which pensions are based will use an average of an individual's past wages rather than the wage in the last year in service.

[2] Budgetary savings from these measures are difficult to quantify but could be up to ¼ of 1 percent of GDP in the short run.

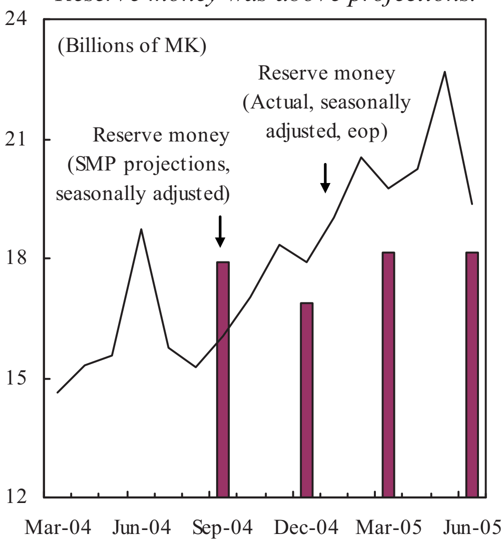
- **The adjusted domestic financing target was met** because higher tax collections offset the wage overrun. The tax buoyancy reflected administrative efficiencies, higher GDP growth, and perhaps an underestimate of national income. However, because of delays in external assistance, domestic debt continued to increase, though it fell relative to GDP.

- **The ceiling on the net domestic assets of the RBM was met and the floor on net foreign assets was exceeded.** However, the liquidity impact of higher foreign assets was not entirely mopped up during 2004 and the first quarter of 2005, and as a consequence, monetary growth and credit to the private sector were higher than envisaged.

Fiscal performance was on track.



Reserve money was above projections.



9. **Resources for the health sector increased sharply in 2004/05 (Box 2).** In particular, Malawi's development partners began to scale up their multiyear commitments through the Health SWAP and the National Aids Commission.[3]

10. **Budgetary performance through end-June is expected to remain on track.** To ensure that expenditures remain within the SMP targets, the ministry of finance reduced

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[3] Donor disbursements are running ahead of expenditures as projects and purchases are scaled up. In consequence, government deposits by the end of the fiscal year will have been built up by about MK 1.8 billion, resulting in a lower level of net government debt.

Box 2. Malawi: Scaling Up Public Health Services

Malawi faces a health crisis worsened by the effects of brain drain. The spread of HIV/AIDS has increased the demand for health services: life expectancy has declined to 39 years, and child mortality remains high at 189 per 1,000 live births. Unfortunately, the health sector is chronically understaffed (e.g., vacancy rates at government posts are as high as 50 percent), ultimately affecting the percentage of health care facilities (10 percent) able to deliver the Essential Health Package (EHP).

The government, with the help of donors, aims to provide adequate health services in the medium term. Two initiatives are now being implemented. The first initiative, the health sectorwide approach (Health SWAp), uses pooled donor resources to help recruit and maintain health workers, in addition to funding existing and new programs. The second initiative, the Malawi Global Fund, aims to scale up the prevention and treatments of HIV/AIDS, malaria, and tuberculosis through the administration of the National AIDS Commission (NAC).

The authorities' medium-term program accommodates a sizable increase in health expenditure. Through the Health SWAp, some US$40 million will be disbursed in 2005/06, with a total of US$200 million committed for the initial six-year period. Through NAC, the budget includes US$40 million a year for drugs, prevention, and treatment. **The IMF-supported program includes this planned expenditure** and, in addition, fully accommodates any increase in spending that might arise because of additional donor support.

Nonwage Health Expenditures (in percent of GDP)

	2004/05	2005/06
Government of Malawi	1.3	1.3
Health SWAp	0.2	1.6
NAC	1.5	2.0
Total	3.0	4.9

Sources: World Bank CEM, and Health SWAp documents.

funding to most ministries by approximately 10 percent for the last quarter of 2004/05. This measure, along with higher revenue collections for the year, should make room for the higher wage bill and additional repayment of domestic arrears, while achieving program targets for the overall deficit (including grants). Domestic financing of the government could be higher than envisaged in the budget because of a temporary shortfall in budget support.

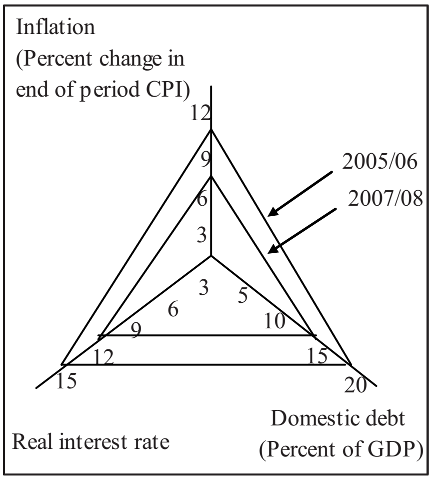
11. **Preliminary data suggest that end-June monetary targets under the SMP were met.** The RBM mopped up the liquidity injections caused by domestic borrowing in the April–June quarter and the unwinding of the end-March repurchase agreement positions.[4]

12. **Domestic petroleum prices were adjusted to close the gap between world and local prices in October 2004 and again in June 2005.** In consequence, the petroleum price stabilization fund, which is used to compensate fuel supply companies if actual landed costs exceed the established price, has remained solvent. It will be important that domestic prices remain in line with world prices through automatic adjustments.

III. THE NEW PROGRAM FOR 2005-08

13. **Malawi faces several fundamental economic challenges.** The uneven implementation of economic policies in the past has left the country with a high debt burden that is consuming a large share of government revenue and is diverting resources from private investment. The economy is inefficient, partly because of insufficient public infrastructure, unreliable utilities, and inadequate institutions. Malawi has been buffeted by bad weather that has worsened an already delicate food security balance, and by high rates of HIV/AIDS and other infectious diseases.

The program will improve macroeconomic stability.



14. **Thus, the government's economic program aims to promote growth by fostering a financially sound and stable macroeconomic environment and by undertaking structural measures to improve economic efficiency**. The program will build on recent successes in macroeconomic stabilization and on strengthening public institutions and infrastructure.[5] Policies are guided by the

[4] A large proportion of repurchase agreements issued to meet end-March targets matured in early April.

[5] The government's quantitative economic targets have been updated in the attached MEFP. They are in line with the APR, but have been revised to account for the dry spell in 2005.

objectives and strategies set out in the MPRSP (2003) that identify economic growth, especially in the rural areas, as the best way to alleviate poverty. Over the next three years, the government's main economic objectives are to:

- raise economic growth to near 6 percent a year, with an emphasis on rural incomes;
- increase health services and educational opportunities;
- reduce core inflation to the 5–8 percent range;
- run a fiscal surplus to reduce the government's domestic debt to less than 15 percent of GDP from over 24 percent;
- build international reserves to at least two months of imports.

Malawi: Medium-Term Objectives

	2003	2004	2005	2006	2007	2008
GDP growth 1/	3.9	4.6	2.1	8.2	5.6	5.9
Inflation (eop) 1/	9.8	13.7	16.9	3.9	7.0	6.9
Underlying balance 2/	-0.9	1.1	1.4	1.9	1.3	0.9
Domestic debt 2/	25.0	24.1	19.8	16.8	14.2	12.3
Gross reserves 3/	1.5	1.3	1.6	2.2	2.4	2.6

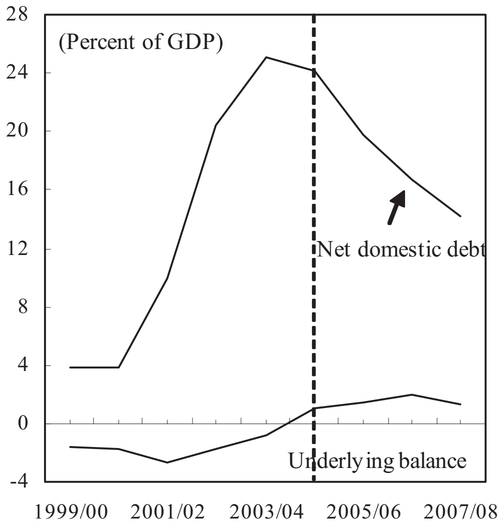
1/ Percent change, calendar year basis.
2/ Percent of GDP, fiscal year basis.
3/ Months of imports, calendar year basis.

15. **The medium-term baseline projections reflect the government's objective to raise economic growth prospects** (MEFP paras. 11-16). The high GDP growth rate in 2006 stems from a rebound in maize production from the depressed level in 2005; above-trend growth rates in the medium term would result from the macroeconomic and structural policies outlined below. These policies focus on activity in rural areas as a means of providing jobs where most Malawians live, export diversification, and reduced dependency on imports.

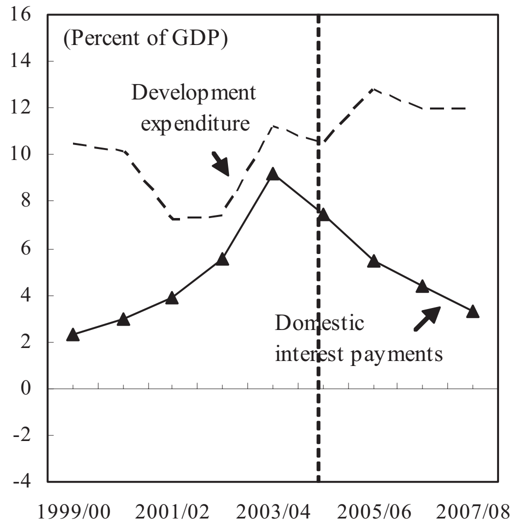
16. **Over the medium term, fiscal policies will aim at reducing the government's absorption of domestic resources while allowing for increases in pro-poor and pro-growth spending**. This will help ease pressures on real interest rates and help maintain a competitive exchange rate. The government's program targets a significant repayment of debt as a means of reducing the interest burden to around 3 percent of GDP. This would allow government resources to be shifted into education, health, and physical infrastructure. Spending in nonpriority areas would be reduced and efficiency gains sought. In the near term, savings measures would build on the government reorganization that followed President Mutharika's election (MEFP para. 42). Additional measures will depend on the

results of the review of the MPRSP, a public expenditure review, and improvements in budget reporting that will help identify possible efficiencies.

Fiscal effort will lead to lower domestic debt...

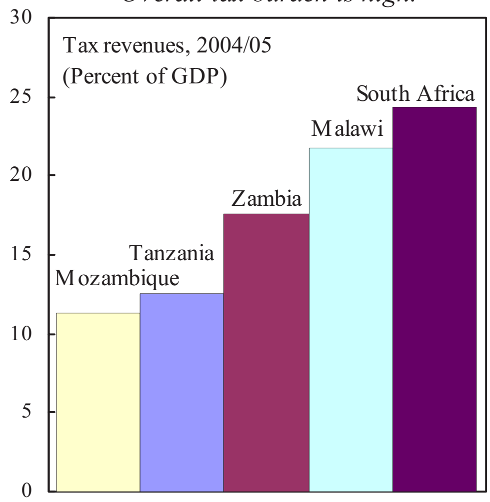


...allowing for more room in the budget.



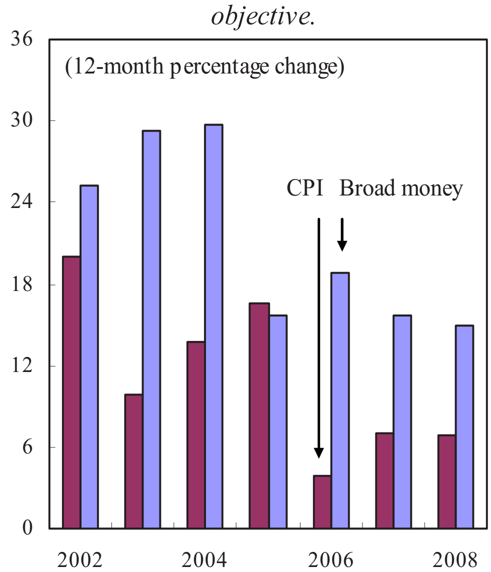
17. **Malawi's resource envelope will depend on both domestic resources and donor support**. Malawi's overall tax burden is already high compared with other countries in the region, and changes in tax policy will be guided by competitiveness concerns with a commitment to revenue neutrality. Nevertheless, significant and predictable donor budget support such as the multiyear commitment to the health sector will remain essential in the period ahead, while humanitarian assistance will be needed periodically because of Malawi's dependence on rain-fed maize production

Overall tax burden is high.



18. **Monetary policy will aim to bring inflation to 5–8 percent by 2008** (MEFP para.26). Broad money will anchor the monetary program with foreign exchange sales and open-market type operations remaining the primary policy levers influencing liquidity.

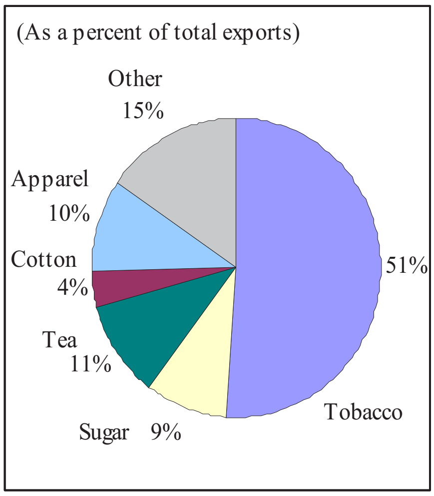
Broad money will anchor the inflation objective.



19. **Because Malawi is vulnerable to external shocks and adverse weather conditions, the authorities' medium-term framework targets a rebuilding of international reserves to at least two months of imports**. Therefore, exchange rate policy will safeguard international reserves. The RBM will continue to smooth the exchange rate through the tobacco cycle by purchasing dollars during the marketing season and selling dollars in other months.

20. **A sustained improvement in external sector prospects will depend on broadening the export base and sustained donor support.** The likely elimination of the EU sugar regime in 2008 would hurt exports, as would drought in the tea and tobacco producing regions. In response, the government is assessing ways to diversify the economy. As recognized in the Malawi Economic Growth Strategy (MEGS) , exporters will benefit significantly from policies directed at reducing the cost of doing business and improving the macroeconomic environment. The multiyear commitment to the health sector and recognition that predictible budget support promotes sound policy implementation bode well.

Exports need to be diversified.



21. **External debt sustainability is expected to remain a serious concern even after Malawi reaches the HIPC completion point** (Appendix V). [6] Consequently, donor support and prudent macroeconomic policies are critical. The authorities reiterated their commitment to obtain or guarantee only concessional loans and make every effort to obtain grants.

[6] Possible implications of the recent proposal from the G8 for debt cancellation and the recently approved IDA 14 replenishment, which will increase the grant component, have not been incorporated into the analysis.

22. **The completion point could be reached by mid-2006 if the outstanding triggers are satisfactorily implemented** (Appendix VI). These include six months of satisfactory performance under the PRGF-supported program (end-December 2005) and one year of successful implementation of the MPRSP. In the areas of World Bank expertise, progress is needed in land and credit reform, the Integrated Financial Management System (IFMIS), procurement and distribution of medication, social safety nets, and teacher training.

23. **The structural reform agenda reflects the government's vision for a more efficient public administration and for growth led by the private sector** (Box 3)**.** The government will first focus on measures to improve macroeconomic policy implementation and then those that would increase overall economic efficiency.

Box 3. Malawi: Fostering Private Sector Growth

The Malawi Economic Growth Strategy identifies the following as the main impediments to economic growth and poverty reduction:

- Inadequate rural roads and rail links to ocean ports raise internal and external transport costs in Malawi. Because exports are lower and more seasonal than imports, it can take months to move imported goods into the country.
- Irrigation is costly and not widely employed, increasing agriculture vulnerabilities.
- Unreliable power supply and telephone services make new investments unattractive.
- Weak public institutions affect macroeconomic stability and hinder investment inflows.

The government is addressing these impediments, with emphasis on rural areas where most Malawians live:

- The National Road Authority is working with the European Union to repair and expand the existing road network. Rail links to ports in Nacala and Beira are being repaired with the cooperation of the government of Mozambique. These improvements will significantly reduce the cost of key imports, in particular, fertilizer. The repair and construction work in rural areas will provide a source of income for farmers.
- Completion of an interconnector from the hydroelectric dam in Cahorra Bassa would significantly expand the supply of electricity by 2007.
- The sale of Malawi Telecom is being reviewed following problems identified during the due diligence phase of the sales agreement.

By increasing fiscal transparency, improving budget procedures, and providing full independence to the central bank, the authorities are expecting to strengthen the institutional framework that would support Malawi's good policies.

24. **The medium-term structural agenda in the fiscal area will cover tax reform, civil service wages and pensions, and public expenditure management.**

- The government completed an **extensive review of tax policies and administration** in early 2005, with the overall objective of a fair and competitive tax regime with efficient administration. Starting with the 2005/06 budget, some tax rates will be reduced and the base broadened (para. 31). Further reforms would also be guided by the need to maintain domestic revenue.

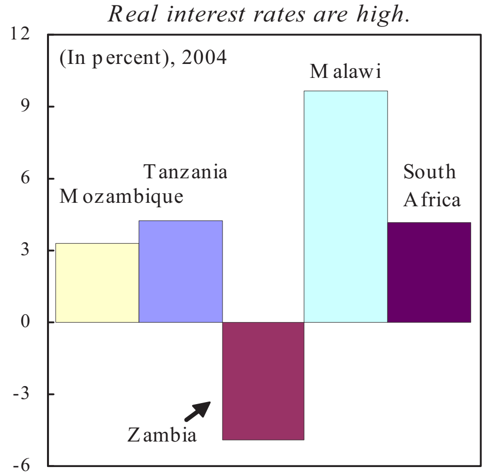
- The **Malawi Revenue Authority** will continue to improve tax collections and services to taxpayers. Training of new tax professionals will be a critical part of this effort.

- The **civil service wage policy will** continue to strengthen incentives and promote transparency (MEFP para. 19). The government will aim to provide additional incentives for key professionals, in particular by topping-up health professional salaries.

- A shift to a **funded pension system** in line with best practice is under consideration. Any move, however, will depend on the budget costs and the macroeconomic consequences of a funded system.[7]

- **Public expenditure management** will be strengthened with a new IFMIS that is being implemented with the assistance of the Government of Tanzania.

Real interest rates are high.



25. **Financial sector structural policies will address market-based policy implementation, the availability of credit at a reasonable cost, and a sound financial system**. The implementation of appropriate fiscal policies has already helped to lower treasury bill yields by 20 percentage points; however, real interest rates are still above those in neighboring countries. Therefore, significant future reductions in borrowing costs for Malawi businesses will require efficiency gains in the financial system.

- The RBM will continue to pursue **financial market efficiency measures** such as market based reforms to treasury bill auctions

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[7] Revisions to the pay-as-you-go pension formula to contain the impact of the October 2004 wage reform on pension costs is a prior action for the approval of the PRGF arrangement.

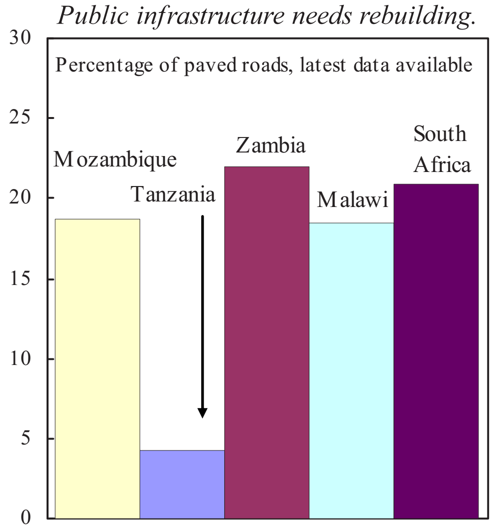
and monetary policy tools. A reduction in the RBM's reserve requirement (currently 27.5 percent) could lower bank costs somewhat and provide room for a lower spread; however, the implicit fiscal costs involved will need to be addressed.

- **Microfinance** is expected to make financial services available to new potential borrowers. The government is implementing a new rural credit scheme, the Malawi Rural Development Fund (MEFP Box 2). The proposed design does not have a direct budget cost, but will imply an implicit government guarantee of up to 2 percent of GDP. Parliament has limited total transfers to MK 5 billion (2 percent of GDP) to restrict the exposure of public resources.

- Capacity in **banking supervision** will be improved. As an initial step, the RBM will analyze the financial sector using tighter credit quality classifications (a structural benchmark) and is considering an FSAP in FY2006/07.

26. **Improvements to Malawi's public infrastructure are intended to address the high cost of doing business in Malawi.** Initially, the government is focusing on internal barriers to trade by repairing and building rural roads and improving international rail links. Priorities for specific projects reflect the MPRSP and will be implemented using an updated Public Sector Investment Project master list that includes many donor-financed projects that were not previously captured in the budget.

Public infrastructure needs rebuilding.



27. **Privatization or commercialization of Malawi's remaining state-owned companies will also help lower business costs** (MEFP paras. 34-35). The government has revised its divesture plan, which retains a focus on Malawi's efficient utilities and on ADMARC, which has been a drain on the budget.[8]

[8] The first phase of ADMARC restructuring is planned for late 2005.

28. **Malawi is pursuing a range of projects to strengthen government institutions.**

- **The new procurement act** (2003) provides a basis for streamlining government purchases.

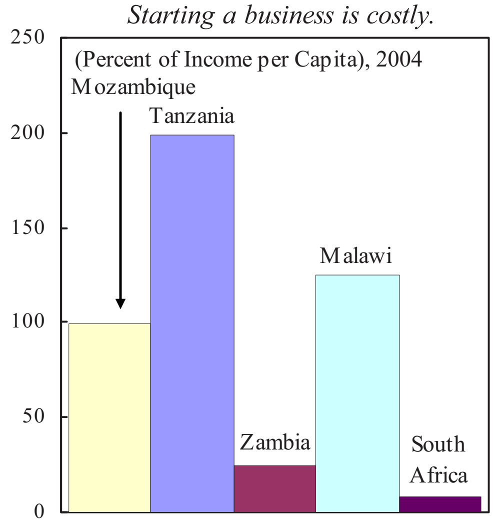
- **Business regulations and licensing requirements will be streamlined**. The government is planning to make it easier to start a new business and bring down associated costs that are at the high end of the range in neighboring countries.

- **The legal system** is being strengthened through efforts to build capacity in the court system, and a commercial court is being developed.

- **Local governments are being given more control of financial resources.** Capacity building, in particular in accounting practices, will be strengthened to reduce the related fiscal risks.

- The government will continue to pursue **low tariffs in regional trade discussions** (MEFP para. 31).

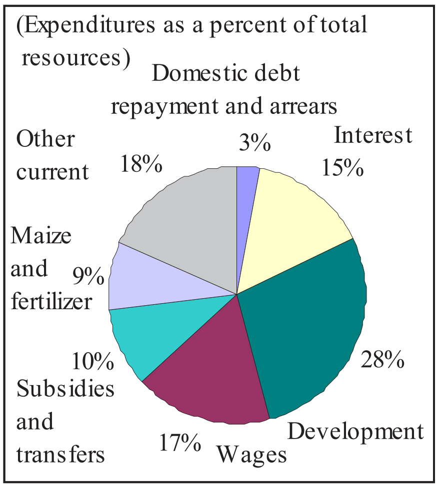
Starting a business is costly.



IV. PROGRAM FOR 2005/06

29. **Malawi's macroeconomic program for 2005/06 focuses on implementation of the budget and sound monetary policy.** The government will also address structural issues, in particular public expenditure management, central bank operations, and tax reform. The dry spell in early 2005, and the jump in fertilizer prices related to world oil prices, has again made food security a primary policy concern.

The budget allows for some debt repayment, but interest payments remain high.



Fiscal policy

30. **The 2005/06 budget framework envisages a large repayment of domestic debt, but also spending increases for health care, education, and humanitarian maize for drought relief.** The domestic underlying balance, a measure of the government's fiscal effort, would improve by about ½ percent of GDP and

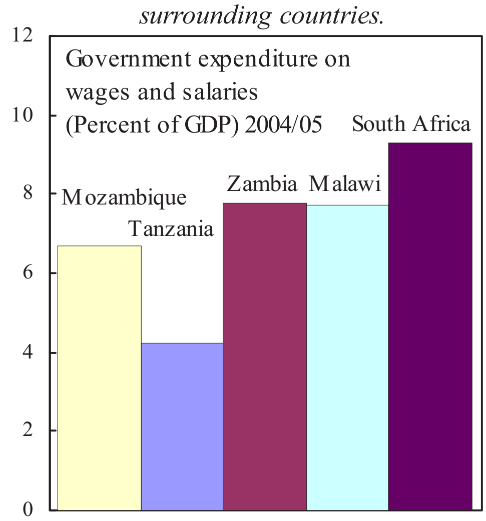
tax revenue would decline slightly as a percent of GDP. Donor disbursements would rise owing to the food shortage and scaling up in the heath sector.

31. **The tax reform package is broadly revenue neutral.** The main aims of the reform this year are to reduce the tax burden on very low income earners by increasing the zero rate bracket of the PAYE and to improve international competitiveness by lowering the top personal bracket. The government will also speed up VAT refunds by making tax refunds a statutory expenditure.[9] In addition, user fees are to be adjusted to keep up with inflation. With the rise in petroleum taxes in early June, tax collections would remain over 21 percent of GDP.

32. **Key expenditure policies in the 2005/06 framework include the following:**

- **The domestically financed government wage bill** would be capped at MK 20 billion (7.7 percent of GDP). The cap allows for a 5 percent increase in government wages from October 2004 plus a moderate amount of funds for normal promotions and wage differentiation for those with experience or special skills.

The wage bill is in line with surrounding countries.



- **The targeted input program (TIP)** in the agricultural sector would be replaced by a subsidy on fertilizers that are mainly used for maize and barley tobacco grown by small-scale farmers. The cost would be increased 0.3 percent of GDP relative to 2004/05 TIP. In the medium term, the government is committed to fiscally-sustainable assistance to agriculture.

- **Government maize purchases would rise** to MK 5.6 billion (2.1 percent of GDP). Most of the maize would go to humanitarian relief. Donors are expected to cover much of the purchase and distribution costs.

- **Health-related purchases** would increase by 2 percent of GDP, with much of the increase reflecting donor participation in the Health SWAP and funding for the National AIDS Council (NAC). Health care salaries would be topped up through this mechanism over the next five years.

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[9] In the past, tax refunds were subject to parliamentary approval. Shifting them to the statutory category will facilitate timely refunds and therefore help business.

- **Subventions to higher education** would be increased to raise salaries. These professionals were not included in the 2004 civil service wage reforms.

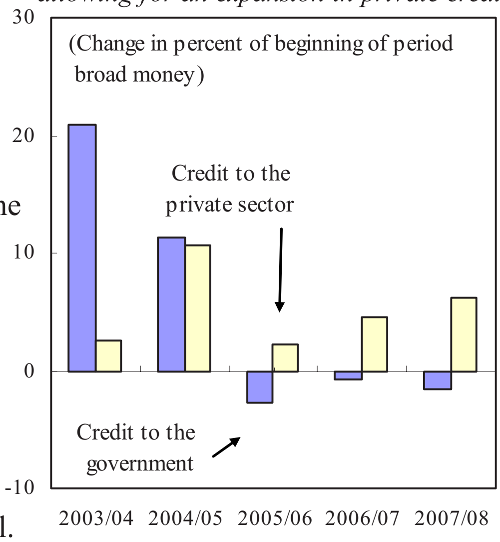
- **Domestic arrears repayment** would rise to near 1 percent of GDP as part of the overall arrears strategy (MEFP para. 44).

- **Four foreign missions** would be closed during 2005/06, with further closings being considered for the following year. Savings would be used to better fund the remaining posts.

33. **Ministries will be expected to live within their approved budgets.** This simple enforcement mechanism proved very effective in turning around policy implementation in 2004/05. To further strengthen budget discipline in 2005/06, controlling officers who exceed their budgets will, in contrast to previous practice, be held accountable under the Finance Management Act (MEFP para. 53).

Monetary and exchange rate policies

Credit to the government will decline, allowing for an expansion in private credit.



34. **Monetary policy will aim to bring nonfood inflation to single digits by end-2006 while allowing for a moderate increase in private sector credit.** To contain broad money growth, the RBM will need to mop up liquidity stemming from government domestic absorption by selling treasury bills during the tobacco marketing season and foreign exchange at other times of the year. The ceiling on net domestic assets and the floor on net foreign assets will continue to be program performance criteria, and reserve money will become an indicative target.

35. **The exchange rate will be market determined, with the RBM acting to limit seasonal exchange rate fluctuations through the purchase and sale of U.S. dollars**. This operating procedure has served Malawi well. The RBM eliminated the informal administrative procedures that were in place during February–mid-March 2005 and has committed to avoiding their use in the future as part of the first review of the PRGF. The staff will look further at the RBM's operating procedures and the use of informal restrictions during early 2005.

36. **In 2005, the external sector outlook will be strongly affected by drought-related food imports**. Maize imports are projected to rise by at least US$60 million and would be financed in part by grants (MEFP Box 4). Malawi would also use its own resources, for example, by reducing or postponing nonessential government imports such as vehicles. In

addition, the World Bank is expected to provide US$20 million in balance of payments support once the PRGF arrangement is approved.[10]

37. **The main focus of the structural agenda in 2005/06 (Box 4) will continue to be public expenditure management (Box 5).** Existing accounting and expenditure controls will be improved at the spending ministry level, and budget execution reporting will be strengthened (a structural benchmark). In addition, the credit ceiling module of the government's new payment system will be made fully operational (a performance criterion). This strategy will help institutionalize the gains in budget discipline seen in 2004/05 and lay the basis for reductions in nonpriority spending in the future.

38. **The government will review civil service wage policies before October to guide the design of the wage increase**. One of the main objectives of the review is to establish a better database on government employees and their distribution within the salary scale so that future wage bill projections will be more accurate (a performance criterion). The government has postponed the introduction of a new civil service pension system until the full impact of reform is determined and compensatory measures identified if needed.

39. **The government will implement the comprehensive strategy to address domestic arrears that has been approved by the cabinet** (MEFP para. 44)**.** It has compiled an inventory of arrears as of end-June 2004 (nearly 4 percent of GDP), and implementation is to begin by end-September 2005 (a performance criterion).

40. **The government is committed to dealing promptly with the maize harvest shortfall.** It will purchase food for targeted, humanitarian purposes and a small amount for a commercial buffer stock (see MEFP Box 4). Key donors are supporting the humanitarian effort with grants and logistical assistance. The government has taken steps to avoid the governance problems that occurred during the 2002 maize crisis, including a transparent bidding process for the sale of the buffer stock at prevailing market prices. Unsold stocks will be used to replenish the strategic grain reserve for 2006/07. The government is pursuing strategies to reduce the risk of food shortages in the future (MEFP paras. 32-33).

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[10] This is currently planned to be disbursed as a top-up to the Fiscal Management and Accelerating Growth Facility (FIMAG) by end-2005.

Box 4. Structural Conditionality

Coverage of Structural Conditionality in the Current Program

A main recommendation of the EPA, more focused conditionality, is incorporated into the program. Prior actions (PA), structural performance criteria (PC), and benchmarks (SB) (Appendix I, Table 2) concentrate on areas that are critical for achieving the program's macroeconomic objectives.

- **Public expenditure management.** This includes improvements in cash management (SB), fully operationalizing the budget ceiling module in the government's payment system (PC), and increasing fiscal transparency (SB).
- **Arrears management.** Approval by cabinet and implementation of a comprehensive arrears strategy (PC and SB).
- **Budget savings.** This includes approval by cabinet of an adjustment formula to curtail the costs of the pension system (PA); compilation of a database of all public employees in order to, for example, improve management of the wage bill (PC and SB); and a new travel policy (PC).
- **Banking supervision.** An impact analysis on the strength of commercial bank balance sheets (SB).

Status of Structural Conditionality from Earlier Programs

Most structural performance criteria and benchmarks under the SMP were observed. In particular, there was a marked improvement in expenditure management. However, some objectives, such as making better use of the financial information captured by the government's new payments system, proved more difficult than anticipated. These issues will be addressed in the new PRGF-supported program.

Box 5. Public Expenditure Management

Past expenditure overruns often reflected a lack of firm commitment and a deterioration in expenditure management. The turnaround in spending control in 2004/05 demonstrated the authorities' commitment to live within the approved budget, but management systems can be improved.

Key elements in strengthening expenditure management and control include the following:

- **Improve cash management.** This will include improving information provided to top managers by strengthening monthly funding tables and ministry expenditure returns and improving the quality of fiscal information. Funding would be withheld from ministries that do not provide adequate expenditure returns.

- **Make operational the budget ceiling module in the government's payment system**. This system will enable effective monitoring of payments through the Credit Ceiling Authority (CCA) system, and it will automatically reject payment for spending that is not approved.

- **Enforce funding ceilings (no new arrears)**. This will be underpinned by the measures mentioned above and by regular visits from the Accountant General's office to supervise the spending ministries. The provisions of the Public Finance Management Act on personal responsibility of senior financial control officers for expenditure overruns will be strictly enforced.

- **Implement a new payroll and human resource system by the beginning of the 2005/06 fiscal year**. All government employees must register to become part of the new payroll system, providing an accurate list of all government employees. The role of the new system, which is envisaged to expand over the next few years, is expected to improve management of government employment.

As part of the expenditure management reforms, the government has decided to replace the current integrated financial management system (IFMIS) with the one used by the Tanzanian government. Although progress was made in implementing IFMIS supported by the World Bank, recent pilot tests revealed serious deficiencies that could not be addressed easily. A pilot project will be initiated, including five cost centers, and training of end users will begin during the 2005/06 fiscal year.

V. PROGRAM ISSUES

Access and capacity to repay the Fund

41. **The proposed access of SDR 38.17 million (55 percent of quota) is in line with standard Fund policies and Malawi's pressing need for balance of payments support related to food import needs this year.**[11] Because of this latter consideration, as well as the need to repay GRA purchases made in 2002 under the IMF's policy for emergency assistance for natural disasters, disbursements will be frontloaded (Table 6a). Malawi's outstanding use of Fund resources (PRGF arrangements and emergency assistance) stood at SDR 57.26 million (82.5 percent of the quota) as of end-May 2005 and would fall to SDR 48.71 million (70.2 percent of quota) at end-2008 (Table 6b).

42. **Malawi's capacity to repay the Fund appears to be sound.** Malawi's record in paying its external debt to the Fund, the World Bank, and other creditors is unblemished; the authorities have continued to service their obligations in full, even at times of foreign exchange shortage.[12] Total debt service obligations are expected to average about 11 percent of exports, and amount to only half of external reserves. The program envisages an increase in debt repayment to the Fund, before HIPC assistance, from SDR 13.4 million (3.5 percent of exports of goods and services) in 2005 to SDR 18.8 million (4.7 percent of exports of goods and services) in 2006 because of repayment under an emergency assistance drawing in September 2002. However, it is expected to fall in the following years.

Risks to the program

43. **Some risks that could arise during the three-year arrangement include:**

- **Inadequate policy implementation**. Continued commitment to reform at the highest political levels will be needed to ensure a sustained break from the past.

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[11] While access of 45 percent of quota is a norm for fourth-time PRGF/ESAF users, the staff proposes an additional SDR 6.94 because of the food crisis.

[12] Paris Club creditors have indicated their readiness (a) to provide a retroactive extension of the consolidation period under the previous rescheduling agreement until a new PRGF arrangement can be approved and (b) to provide further possible assistance once a new PRGF arrangement is approved. In staff's view, satisfactory assurances regarding the exceptional assistance to be provided under the enhanced HIPC Initiative by Malawi's other creditors, including Paris Club creditors, continue to be in place.

- **External and weather shocks**. Malawi is vulnerable to shocks, mainly due to its narrow export base and dependence on agriculture. This underscores the importance of reserve accumulation and the strategy of growth through diversification.

- **Volatility of donor support.** Sustained program implementation will help ensure that donor flows materialize as anticipated.

Program monitoring and conditionality

44. **Because of the risks mentioned above, the program will be monitored closely during the first year of the arrangement.** The first and second program reviews will be based on end-September and end-December 2005 performance criteria, and the third program review on end-March and end-June 2006 performance criteria. The program includes two prior actions, (1) approval of a 2005/06 budget that is in line with the proposed PRGF framework and (2) changes to the pension formula to contain costs. The quantitative performance criteria and indicative targets are shown in Table 1 of the MEFP. Structural performance criteria and benchmarks are shown in Table 2 of the MEFP. Quantitative and structural conditionality are defined in the technical memorandum of understanding (TMU).

45. **A new full safeguards assessment of the RBM has been initiated and is expected to be completed before the first program review.** An earlier assessment was completed in July 2003. This assessment concluded that vulnerabilities existed in the external audit, internal control, and legal areas of the RBM, and recommendations were made to mitigate the existing risks. The authorities confirmed that several recommendations have been implemented and the RBM is working on addressing the remaining concerns.

Data issues, technical assistance, and capacity building

46. **The quality of data for program monitoring purposes is adequate**. Over the course of the SMP, the quality and timing of the fiscal and monetary data needed to evaluate Malawi's quantitative performance have improved. The government has also made improvements in disseminating monetary and fiscal policy data to the public and donor community.

47. **The authorities are committed to strengthening technical capacity within the government and RBM**. The authorities are pursuing technical assistance from the Fund in several areas, including statistics, tax policy, banking supervision, and monetary operations.

VI. Staff Appraisal

48. **Policy implementation under the SMP has been much stronger than in previous years**. Through March 2005, Malawi met all quantitative conditions, with the exception of the ceiling on wages that was exceeded because the cost of civil service wage reform was underestimated. Current spending was close to the budget approved by parliament, with

nearly all ministries spending within their approved limits. This is a major break from previous episodes when spending limits were exceeded by wide margins and substantial domestic arrears incurred.

49. **Macroeconomic performance during 2004 was better than expected.** GDP growth exceeded initial projections, mainly due to strong tobacco production. Inflation picked up during 2004, but remained below the envisaged level. Growth and inflation prospects for 2005 have been negatively affected by a dry spell during the crop growing season. The resulting grain shortage is serious and will require concerted action on the part of the government, donors, and NGOs.

50. **Malawi must overcome daunting economic challenges to make significant progress toward the MDGs.** A sound macroeconomic environment—anchored by continued containment of extrabudgetary spending—and measures to promote private sector development are necessary conditions for sustained poverty reduction and economic growth.

51. **The authorities' medium-term fiscal objectives are realistic.** The goal of reducing domestic debt to 15 percent of GDP or less and limiting non-priority spending is appropriate. Freeing resources in this way will allow the authorities to address priority areas such as health, education, and public infrastructure. It will also help further lower interest rates and maintain a competitive exchange rate. The budget framework for 2005/06 and the envisaged increases in resources for healthcare, food security, and other priorities are welcome. Achievement of the projected reduction in domestic debt in 2005/06 and later years is critical.

52. **The RBM will need to remain vigilant in containing inflationary pressures.** While the domestic debt repayment projected for 2005/06 should ease the burden on monetary policy, the high rate of money growth during 2004 and part of this year has weakened the currency and could lead to higher inflation. It will be important for the RBM to meet its monetary targets.

53. **The recent depreciation of the kwacha and the phasing out of informal administrative restrictions on foreign exchange are appropriate steps**. The government will need to refrain from administrative restrictions on foreign exchange sales and also rebuild its foreign exchange reserves by avoiding excessive intervention in support of the exchange rate.

54. **Implementation of Malawi's structural reform agenda will be a key determinant in sustained poverty reduction**. Improved financial management will also help channel spending to high priority areas and reduce the chances of a buildup in domestic arrears. Tax reform, infrastructure investment, privatization, and trade initiatives will be critical to reduce business costs and promote industrial efficiency and competitiveness. The rural development fund could foster growth and poverty reduction, but the government will need to implement the plan carefully to avoid unacceptable levels of bad loans.

55. **Food security is, rightly, an overarching policy priority**. The government's early action to avert a food crisis in 2005/06, its cooperation with donors, and its ongoing zero tolerance for corruption will help avoid many of the problems seen during the 2002 crisis. Regrettably, food emergencies are becoming increasingly common in Malawi and more permanent solutions to food security are needed. Improving transportation infrastructure to strengthen markets for agricultural inputs and outputs, the willingness of government to change its fertilizer program, and the intention to revisit agricultural policies are important steps to greater food security.

56. **The staff welcomes the government's initiative to update its poverty reduction strategy**. Since taking office in May 2004, the government and stakeholders have worked together to enhance the growth pillar of the MPRS and set priorities for tax reform. A revised poverty reduction strategy incorporating these developments and scaled-up donor support for the health sector is appropriate.

57. **In light of Malawi's recent satisfactory performance under the SMP and the authorities' commitment to macroeconomic stability, the staff recommends the approval of the authorities request for a three-year PRGF arrangement and additional HIPC interim assistance.** The 2005/06 budget will be in line with the proposed PRGF-supported program, and the revision to the pension formula will keep costs at the budgeted level. The proposed access and phasing under the PRGF arrangement strike an appropriate balance between the need to support Malawi's efforts to achieve sustained growth and poverty reduction and the risks to the Fund. The frontloading is justified by the balance of payments need associated with the serious maize shortage.

Table 1a. Malawi: Selected Economic Indicators, 2002-08

	2002	2003	2004		2005	2006	2007	2008
	Est.	Est.	SMP	Est.	Proj.	Proj.	Proj.	Proj.
National income and prices								
GDP at constant factor prices	2.1	3.9	3.9	4.6	2.1	8.2	5.6	5.9
Nominal GDP (in billions of kwacha)	148.4	171.9	197.4	204.6	240.9	287.1	328.6	373.4
Nominal GDP per capita (in U.S. dollars)	163.0	145.8	...	152.2	158.2	162.4	171.2	181.2
GDP deflator	16.6	9.2	14.7	11.6	16.2	10.2	8.4	7.3
Consumer prices (end of period)	7.6	9.8	20.0	13.7	16.9	3.9	7.0	6.9
Food	4.5	3.0	...	14.1	19.2	0.5	7.0	7.0
Nonfood	11.2	20.2	...	13.2	13.8	8.7	7.1	6.8
Consumer prices (annual average)	14.9	9.6	14.9	11.5	15.5	9.4	7.8	7.0
Investment and savings (percent of GDP)								
National savings	-0.8	3.3	1.9	3.2	10.4	12.7	11.3	10.8
Of which : domestic savings	-11.0	-11.6	-3.5	-12.0	-8.1	-5.2	-5.7	-4.9
unrequited transfers	12.6	17.3	7.6	17.6	20.6	19.9	18.7	17.2
Gross investment	10.4	10.9	11.1	11.2	16.4	15.9	16.1	16.4
Foreign savings	-11.2	-7.6	-9.2	-8.0	-6.0	-3.2	-4.8	-5.6
Central government (percent of GDP)								
Revenue (excluding grants)	17.7	22.0	...	23.6	24.8	24.2	24.3	24.1
Expenditure	35.1	39.3	...	41.1	48.3	41.3	39.8	38.7
Of which : domestic expenditure	27.8	29.8	...	32.1	35.7	29.3	28.4	27.9
Underlying balance 1/	-2.8	-0.5	...	1.0	-1.5	2.2	1.6	1.0
Domestic balance	-10.1	-7.8	...	-8.5	-11.1	-5.1	-4.1	-3.8
Overall balance	-11.6	-6.5	...	-5.9	-4.6	-0.8	-0.3	-0.8
Money and credit (change in percent of beginning-of-year M2)								
Money and quasi money	25.2	29.3	25.5	29.8	16.1	18.4	15.7	14.9
Net foreign assets	-55.4	21.5	1.8	6.0	10.8	18.0	7.2	7.7
Net domestic assets	80.6	7.8	23.8	23.8	5.3	0.4	8.5	7.2
Credit to the government	45.1	11.3	36.4	10.3	17.4	-2.2	-2.8	-2.4
Credit to the rest of the economy	4.1	8.1	1.2	11.3	4.9	4.7	7.9	8.5
Velocity	5.4	4.9	4.6	4.5	4.5	4.6	4.5	4.5
External sector (millions of U.S. dollars)								
Exports, f.o.b.	421.1	440.6	476.4	470.4	536.4	571.5	591.0	617.3
Imports, c.i.f.	-726.8	-791.6	-703.0	-866.2	-983.7	-963.6	-1,029.3	-1,077.8
Usable gross official reserves	103.4	115.6	84.8	119.3	142.2	210.8	233.8	274.6
(months of imports)	1.4	1.5	1.3	1.3	1.6	2.3	2.4	2.6
Nominal effective exchange rate 2/	-34.4	-30.2	...	-7.7	-1.3	...	...	...
Real effective exchange rate 2/	-30.9	-24.3	...	1.8	4.1	...	...	...
Terms of trade	-7.4	-3.2	-0.8	-1.3	-7.5	4.6	0.0	0.0
Debt stock and service (percent of GDP)								
External debt (public sector)	143.3	158.9	160.7	150.0	143.7	139.3	131.0	122.6
NPV of debt (percent of avg. exports)	299.3	295.0	...	291.0	274.4	255.8	240.9	232.8
External debt service (percent of exports)	18.3	21.8	21.1	22.9	18.9	21.8	20.3	17.1
Net domestic debt (central government)	17.4	22.3	27.3	22.9	22.0	18.0	15.0	12.5
Domestic interest payment	4.0	7.9	...	8.5	6.2	5.0	3.7	2.9
Treasury bill rate (period average) 2/	41.7	39.3	...	28.6	24.4	...	...	...

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

1/ A measure of domestic adjustment effort (i.e., domestic primary balance excluding maize and the Health SWAp). Definition: Overall balance plus statistical discrepancy, excluding grants, revenue and expenditure from maize, interest, foreign-financed development expenditures, and the Health SWAp.

2/ Based on data through April 2005.

Table 1b. Malawi: Selected Economic Indicators on a Fiscal Year Basis (July–June), 2002/03-2008/09

	2002/03	2003/04	2004/05		2005/06	2006/07	2007/08	2008/09
	Est.	Est.	SMP	Proj.	Proj.	Proj.	Proj.	Proj.
National income and prices								
GDP at constant factor prices	3.0	4.3	...	3.3	5.2	6.8	5.8	5.9
Nominal GDP (in billions of kwacha)	160.1	188.3	216.1	222.8	264.0	307.8	351.0	398.8
Nominal GDP per capita (in U.S. dollars)	156.8	144.5	...	161.0	157.1	166.8	176.4	187.1
GDP deflator	15.6	10.5	...	14.0	13.0	9.2	7.8	7.3
Consumer prices (end of period)	8.6	11.6	...	14.9	11.0	10.8	7.4	8.1
Food	4.0	6.3	...	18.2	9.9	13.2	7.8	8.9
Nonfood	15.1	18.4	...	11.1	12.3	7.9	7.0	7.0
Consumer prices (annual average)	16.7	10.2	...	13.5	15.1	5.8	7.9	6.9
Investment and savings (percent of GDP)								
National savings	0.2	5.2	...	6.3	11.9	11.8	11.1	11.5
Of which : domestic savings	-12.5	-9.9	...	-10.8	-6.2	-5.6	-5.2	-4.4
unrequited transfers	15.1	17.5	...	19.2	20.2	19.3	17.9	17.4
Gross investment	9.5	13.0	...	13.2	16.4	15.9	16.3	16.9
Foreign savings	-9.3	-7.8	...	-6.9	-4.4	-4.1	-5.3	-5.5
Central government (percent of GDP)								
Revenue (excluding grants)	20.0	22.7	24.0	24.8	24.6	24.4	24.2	24.0
Expenditure	38.3	42.8	40.0	42.6	44.7	40.6	39.2	38.4
Of which : domestic expenditure	31.0	31.9	31.0	32.0	32.1	28.9	28.2	27.3
Underlying balance 1/	-1.7	-0.9	1.2	1.1	1.4	1.9	1.3	0.9
Domestic balance	-11.0	-9.2	-7.0	-7.5	-7.5	-4.5	-4.0	-3.4
Overall balance	-11.6	-7.8	-4.3	-4.1	-1.3	-0.9	-0.7	-1.1
Money and credit (change in percent of beginning-of-year M2)								
Money and quasi money	24.1	35.6	...	19.8	18.5	17.2	15.3	14.9
Net foreign assets	-5.3	8.6	...	1.4	21.3	10.6	8.1	2.5
Net domestic assets	29.4	27.0	...	18.4	-2.8	6.7	7.2	12.4
Credit to the government	40.3	20.9	...	11.3	-2.7	-0.8	-1.6	-0.9
Credit to the rest of the economy	7.5	2.5	...	10.6	2.3	4.5	6.2	8.4
Velocity	5.3	4.6	4.6	4.6	4.6	4.6	4.5	4.5
External sector (millions of U.S. dollars)								
Exports, f.o.b.	422.2	447.7	...	506.8	544.1	577.5	601.2	630.9
Imports, c.i.f.	-850.6	-770.1	...	-906.9	-983.8	-1,006.6	-1,036.3	-1,110.0
Usable gross official reserves	89.7	93.5	...	117.7	166.5	205.2	240.0	245.2
(months of imports)	1.1	1.1	...	1.3	1.8	2.1	2.3	2.2
Nominal effective exchange rate 2/	-26.1	-23.9	...	-7.7	...	...	...	...
Real effective exchange rate 2/	-22.6	-17.0	...	9.2	...	...	...	...
Domestic debt (percent of GDP)								
Net domestic debt (central government)	20.4	25.0	23.7	24.1	19.8	16.8	14.2	12.3
Domestic interest payment	5.5	9.2	7.8	7.4	5.4	4.4	3.3	2.5
Treasury bill rate (period average) 2/	38.3	36.3	...	24.5	...	...	...	...

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

1/ A measure of domestic adjustment effort (i.e., domestic primary balance excluding maize and the Health SWAp). Definition: Overall balance plus statistical discrepancy, excluding grants, revenue and expenditure from maize, interest, foreign-financed development expenditures, and the Health SWAp.

2/ Based on data through April 2005.

Table 2a: Malawi: Central Government Operations, 2004/05 and 2005/06
(In millions of Malawi kwacha)

	2004/05						2005/06					
	Q1 Act.	Q2 Act.	Q3 Act.	Q4 Proj.	Annual Proj.	Percent of GDP	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.	Percent of GDP
Total revenue and grants	14,225	24,519	18,038	29,596	86,378	38.8	31,125	27,103	30,136	26,428	114,792	43.5
Revenue	12,727	13,143	15,016	14,409	55,295	24.8	15,457	14,912	17,128	17,454	64,950	24.6
Tax revenue	11,143	11,765	12,995	12,574	48,477	21.8	13,742	12,932	14,508	15,506	56,688	21.5
Nontax revenue	1,584	1,378	2,021	1,835	6,818	3.1	1,715	1,980	2,620	1,947	8,262	3.1
Of which : sale receipts from maize	0	55	68	340	463	0.2	170	334	840	0	1,344	0.5
Grants	1,498	11,376	3,022	15,187	31,083	14.0	15,669	12,191	13,008	8,974	49,842	18.9
Program/ budget support	330	3,698	0	1,122	5,150	2.3	7,644	2,617	4,837	0	15,098	5.7
Project	230	2,837	272	10,203	13,543	6.1	3,330	3,501	3,892	3,659	14,383	5.4
Dedicated grants	89	3,314	1,408	2,755	7,566	3.4	3,162	4,178	2,288	3,288	12,916	4.9
HIPC debt relief	849	1,527	1,341	1,107	4,823	2.2	1,533	1,894	1,992	2,026	7,445	2.8
Total expenditure and net lending	17,392	23,818	23,862	30,450	95,521	42.9	31,184	31,561	28,012	27,350	118,108	44.7
Current expenditure	14,980	17,484	20,974	18,287	71,726	32.2	23,228	22,809	19,525	18,749	84,310	31.9
Wages and salaries	3,228	4,547	4,571	4,812	17,158	7.7	4,848	5,086	5,284	5,512	20,730	7.9
Of which : Health Swap	0	0	0	141	141	0.1	177	181	184	188	730	0.3
Interest payments	5,778	4,562	4,862	4,260	19,462	8.7	4,194	4,357	4,902	4,278	17,730	6.7
Domestic	5,126	3,571	4,256	3,580	16,532	7.4	3,530	3,493	3,998	3,359	14,381	5.4
Foreign	651	991	607	680	2,930	1.3	663	864	903	919	3,349	1.3
Other current expenditure	5,975	8,375	11,541	9,216	35,106	15.8	14,187	13,366	9,339	8,958	45,850	17.4
Other purchases of goods and services	3,748	4,643	5,900	5,555	19,846	8.9	8,597	7,378	5,897	5,474	27,346	10.4
Of which : maize purchases	100	650	1,105	644	2,499	1.1	3,169	1,896	538	0	5,603	2.1
Health SWAp	0	0	0	391	391	0.2	1,016	1,046	1,063	1,075	4,200	1.6
Subsidies and other current transfers	2,227	3,465	5,207	3,359	14,258	6.4	5,090	5,487	2,943	2,984	16,504	6.3
Pension and gratuities	420	447	595	644	2,106	0.9	802	802	802	802	3,208	1.2
TIP + fertilizer subsidy	0	869	1,838	588	3,295	1.5	2,200	2,600	0	0	4,800	1.8
DFID/TIP	19	363	695	0	1,077	0.5	0	0	0	0	0	0.0
Other subsidies and transfers	1,788	1,786	2,079	2,127	7,780	3.5	2,088	2,085	2,141	2,182	8,496	3.2
Arrears	0	266	434	302	1,002	0.4	500	500	500	500	2,000	0.8
Development expenditure	2,412	6,335	2,887	11,573	23,207	10.4	7,956	8,752	8,487	8,602	33,797	12.8
Part I (foreign financed)	1,908	5,798	2,191	10,717	20,615	9.3	7,021	7,817	7,532	7,609	29,978	11.4
Part II (domestically financed)	504	536	696	856	2,592	1.2	936	936	955	993	3,819	1.4
Net lending	0	0	0	589	589	0.3	0	0	0	0	0	0.0
Overall balance (including grants)	-3,167	701	-5,824	-854	-9,143	-4.1	-59	-4,458	2,124	-923	-3,316	-1.3
Total financing	3,801	-1,934	5,533	1,744	9,143	4.1	59	4,458	-2,124	923	3,316	1.3
Foreign (net)	2,909	-844	-816	1,289	2,538	1.1	842	4,274	-324	-84	4,707	1.8
Borrowing	4,133	740	639	2,396	7,908	3.5	2,421	6,279	2,300	2,586	13,585	5.1
Program	2,993	0	0	2,134	5,127	2.3	0	3,272	0	0	3,272	1.2
Project	1,140	740	639	262	2,781	1.2	2,421	3,007	2,300	2,586	10,314	3.9
Amortization	-1,525	-2,641	-1,897	-1,625	-7,688	-3.5	-1,919	-2,179	-2,624	-2,670	-9,393	-3.6
Special loans (net)	0	264	266	283	813	0.4	0	0	0	0	0	0.0
Foreign bank accounts	302	793	177	233	1,504	0.7	340	175	0	0	515	0.2
Domestic (net)	892	-1,089	6,348	455	6,606	3.0	-783	184	-1,800	1,007	-1,391	-0.5
Financial instruments	892	-1,089	6,348	455	6,606	3.0	-783	184	-1,800	1,007	-1,391	-0.5
Banking system	-2,827	-910	6,972	1,593	4,828	2.2	-783	184	-1,800	1,007	-1,391	-0.5
Nonbanks	3,719	-179	-623	-1,138	1,778	0.8	0	0	0	0	0	0.0
Discrepancy	-634	1,232	292	-890	0	0.0	0	0	0	0	0	0.0
Memorandum items:												
Nominal GDP	222,774	222,774	222,774	222,774	222,774	100.0	263,994	263,994	263,994	263,994	263,994	100.0
Net domestic debt	47,996	46,907	53,255	53,710	53,710	24.1	52,927	53,112	51,312	52,319	52,319	19.8

Sources: Malawian authorities; and IMF staff estimates.

Table 2b: Malawi: Central Government Operations, 2002/03 - 2008/09
(In millions of Malawi kwacha)

	2002/03	2003/04	2004/05		2005/06	2006/07	2007/08	2008/09
	Actual	Actual	SMP	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	42,685	65,817	77,094	86,378	114,792	122,338	135,279	148,780
Revenue	32,009	42,754	51,881	55,295	64,950	75,177	84,910	95,606
Tax revenue	27,251	36,902	44,747	48,477	56,688	65,911	74,838	84,668
Nontax revenue	4,758	5,852	7,135	6,818	8,262	9,266	10,073	10,938
Of which : sale receipts from maize	591	1,351	2,160	463	1,344	1,500	1,500	1,500
Grants	10,675	23,063	25,212	31,083	49,842	47,161	50,368	53,174
Program/ budget support	1,220	6,576	5,418	5,150	15,098	10,533	11,160	9,039
Project	4,604	6,518	13,799	13,543	14,383	16,201	17,548	27,843
Dedicated grants	188	4,219	0	7,566	12,916	12,173	13,241	7,662
HIPC debt relief	3,588	5,261	5,995	4,823	7,445	8,253	8,419	8,630
Japanese debt relief	1,075	490	...	...	...	...	...	...
Total expenditure and net lending	61,322	80,536	86,351	95,521	118,108	124,995	137,723	153,146
Current expenditure	49,473	59,537	67,403	71,726	84,310	88,186	95,882	105,112
Wages and salaries	10,930	12,337	15,300	17,158	20,730	25,738	28,947	32,264
Of which : Health SWAp	...	...	...	141	730	2,416	2,705	2,840
Interest payments	10,985	20,024	19,427	19,462	17,730	17,207	15,520	13,934
Domestic	8,871	17,253	16,863	16,532	14,381	13,402	11,558	9,832
Foreign	2,114	2,771	2,565	2,930	3,349	3,806	3,962	4,102
Other current expenditure	27,559	27,176	32,676	35,106	45,850	45,241	51,415	58,914
Other purchases of goods and services	20,127	18,416	19,689	19,846	27,346	25,180	30,559	37,124
Of which : maize purchase	6,078	0	2,890	2,499	5,603	1,500	1,500	1,500
Health SWAp	...	...	...	391	4,200	3,989	4,306	4,260
Subsidies and other current transfers	7,431	7,410	12,488	14,258	16,504	18,061	18,856	19,790
Pension and gratuities	1,431	1,613	2,379	2,106	3,208	4,708	5,465	6,312
TIP/fertilizer subsidy	0	0	2,500	3,295	4,800	4,300	3,800	3,300
DFID financed TIP costs	0	0	0	1,077	0	0	0	0
Other subsidies and transfers	6,000	5,797	7,609	7,780	8,496	9,053	9,591	10,178
Arrears	0	1,349	500	1,002	2,000	2,000	2,000	2,000
Development expenditure	11,787	20,999	18,947	23,207	33,797	36,809	41,841	48,034
Part I (foreign financed)	9,521	17,681	16,804	20,615	29,978	32,191	34,821	40,057
Part II (domestically financed)	2,266	3,319	2,143	2,592	3,819	4,618	7,020	7,976
Net lending	61	0	0	589	0	0	0	0
Overall balance (including grants)	-18,637	-14,719	-9,257	-9,143	-3,316	-2,657	-2,444	-4,365
Total financing	18,099	14,938	9,257	9,143	3,316	2,657	2,444	4,365
Foreign (net)	-730	425	5,063	2,538	4,707	3,389	4,051	5,435
Borrowing	4,917	7,185	11,215	7,908	13,585	14,748	15,966	17,754
Program	0	1,386	8,434	5,127	3,272	4,444	4,704	5,540
Project	4,917	5,799	2,781	2,781	10,314	10,304	11,261	12,214
Dedicated loans	0	0	0	0	0	0	0	0
Amortization	-5,448	-7,577	-8,428	-7,688	-9,393	-11,359	-11,915	-12,319
Special loans (net)	-323	0	889	813	0	0	0	0
Foreign bank accounts	125	817	1,386	1,504	515	0	0	0
Domestic (net)	18,829	14,512	4,194	6,606	-1,391	-732	-1,607	-1,070
Financial instruments	19,136	14,450	4,194	6,606	-1,391	-732	-1,607	-1,070
Banking system	13,922	6,601	...	4,828	-1,391	-513	-1,125	-749
Nonbanks	5,213	7,850	...	1,778	0	-220	-482	-321
Informal financing arrangements	-307	62	0	0	0	0	0	0
Discrepancy (- is overfinancing)	538	-218	0	0	0	0	0	0
Memorandum items:								
Nominal GDP	160,137	188,279	216,129	222,774	263,994	307,837	351,003	398,825
Net domestic debt	32,654	47,104	51,298	53,710	52,319	51,587	49,980	48,910
Underlying balance 1/	-2,781	-1,648	2,492	2,418	3,739	5,987	4,540	3,553
Cash foreign financing (net of amortization)	425	11,172	13,695	13,969	24,571	18,359	19,598	18,551

Sources: Malawian authorities; and IMF staff estimates.

1/ The underlying balance is a measure of domestic adjustment effort, specifically the domestic primary balance, excluding maize operations and the Health SW/
Definition: Overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize and the Health SWA
plus foreign-financed development expenditures.

Table 2c: Malawi: Central Government Operations, 2002/03 - 2008/09
(In percent of GDP)

	2002/03	2003/04	2004/05		2005/06	2006/07	2007/08	2008/09
	Actual	Actual	SMP	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	26.7	35.0	35.7	38.8	43.5	39.7	38.5	37.3
Revenue	20.0	22.7	24.0	24.8	24.6	24.4	24.2	24.0
Tax revenue	17.0	19.6	20.7	21.8	21.5	21.4	21.3	21.2
Nontax revenue	3.0	3.1	3.3	3.1	3.1	3.0	2.9	2.7
of which : Sale receipts from maize	0.4	0.7	1.0	0.2	0.5	0.5	0.4	0.4
Grants	6.7	12.2	11.7	14.0	18.9	15.3	14.3	13.3
Program/ budget support	0.8	3.5	2.5	2.3	5.7	3.4	3.2	2.3
Project	2.9	3.5	6.4	6.1	5.4	5.3	5.0	7.0
Dedicated grants	0.1	2.2	0.0	3.4	4.9	4.0	3.8	1.9
HIPC debt relief	2.2	2.8	2.8	2.2	2.8	2.7	2.4	2.2
Japanese debt relief	0.7	0.3	...	...	...	...	...	...
Total expenditure and net lending	38.3	42.8	40.0	42.9	44.7	40.6	39.2	38.4
Current expenditure	30.9	31.6	31.2	32.2	31.9	28.6	27.3	26.4
Wages and salaries	6.8	6.6	7.1	7.7	7.9	8.4	8.2	8.1
Of which : Health SWAp	...	...	...	0.1	0.3	0.8	0.8	0.7
Interest payments	6.9	10.6	9.0	8.7	6.7	5.6	4.4	3.5
Domestic	5.5	9.2	7.8	7.4	5.4	4.4	3.3	2.5
Foreign	1.3	1.5	1.2	1.3	1.3	1.2	1.1	1.0
Other current expenditure	17.2	14.4	15.1	15.8	17.4	14.7	14.6	14.8
Other purchases of goods and services	12.6	9.8	9.1	8.9	10.4	8.2	8.7	9.3
Of which : Maize purchases	3.8	0.0	1.3	1.1	2.1	0.5	0.4	0.4
Health SWAp	...	...	...	0.2	1.6	1.3	1.2	1.1
Subsidies and other current transfers	4.6	3.9	5.8	6.4	6.3	5.9	5.4	5.0
Pension and gratuities	0.9	0.9	1.1	0.9	1.2	1.5	1.6	1.6
TIP/fertilizer subsidy	0.0	0.0	1.2	1.5	1.8	1.4	1.1	0.8
DFID financed TIP costs	0.0	0.0	0.0	0.5	0.0	0.0	0.0	0.0
Other subsidies and transfers	3.7	3.1	3.5	3.5	3.2	2.9	2.7	2.6
Arrears	0.0	0.7	0.2	0.4	0.8	0.6	0.6	0.5
Development expenditure	7.4	11.2	8.8	10.4	12.8	12.0	11.9	12.0
Part I (foreign financed)	5.9	9.4	7.8	9.3	11.4	10.5	9.9	10.0
Part II (domestically financed)	1.4	1.8	1.0	1.2	1.4	1.5	2.0	2.0
Net lending	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0
Overall balance (including grants)	-11.6	-7.8	-4.3	-4.1	-1.3	-0.9	-0.7	-1.1
Total financing	11.3	7.9	4.3	4.1	1.3	0.9	0.7	1.1
Foreign (net)	-0.5	0.2	2.3	1.1	1.8	1.1	1.2	1.4
Borrowing	3.1	3.8	5.2	3.5	5.1	4.8	4.5	4.5
Program	0.0	0.7	3.9	2.3	1.2	1.4	1.3	1.4
Project	3.1	3.1	1.3	1.2	3.9	3.3	3.2	3.1
Dedicated loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-3.4	-4.0	-3.9	-3.5	-3.6	-3.7	-3.4	-3.1
Special loans (net)	-0.2	0.0	0.4	0.4	0.0	0.0	0.0	0.0
Foreign bank accounts	0.1	0.4	0.6	0.7	0.2	0.0	0.0	0.0
Domestic (net)	11.8	7.7	1.9	3.0	-0.5	-0.2	-0.5	-0.3
Financial instruments	11.9	7.7	1.9	3.0	-0.5	-0.2	-0.5	-0.3
Banking system	8.7	3.5	...	2.2	-0.5	-0.2	-0.3	-0.2
Nonbanks	3.3	4.2	...	0.8	0.0	-0.1	-0.1	-0.1
Informal financing arrangements	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discrepancy (- is overfinancing)	0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Net domestic debt	20.4	25.0	23.7	24.1	19.8	16.8	14.2	12.3
Underlying balance 1/	-1.7	-0.9	1.2	1.1	1.4	1.9	1.3	0.9
Cash foreign financing (net of amortization)	0.3	5.9	6.3	6.3	9.3	6.0	5.6	4.7

Sources: Malawian authorities; and IMF staff estimates.
1/ The underlying balance is a measure of domestic adjustment effort, specifically the domestic primary balance, excluding maize operations and the Health SWAp. Definition: Overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize and the Health SWAp, plus foreign-financed development expenditures.

Table 3a. Malawi : Monetary Authorities' Balance Sheet, 2004-06
(In millions of Malawi kwacha, unless otherwise indicated)

	2004				2005							2006	
	Q3		Q4		Q1		Q2			Q3	Q4	Q1	Q2
	SMP	Act.	SMP	Act.	SMP	Act.	SMP	SMP-Adj. 1/	Proj.	Proj.	Proj.	Proj.	Proj.
Reserve money	18,800	16,728	17,193	17,967	14,864	16,196	18,674	18,674	19,580	20,894	20,904	17,896	23,013
Currency outside banks	...	11,505	...	10,993	...	9,976	...	...	...	...	...	...	...
Cash in vault	...	1,440	...	1,861	...	1,567	...	...	...	...	...	...	...
Commercial bank deposits with RBM	...	3,782	...	5,114	...	4,653	...	...	...	...	...	...	...
Net foreign assets (NFA)	-1,275	3,369	-322	2,919	-1,472	93	3,685	1,080	4,061	8,507	7,223	5,162	10,101
NFA (in millions of U.S. dollars)	-11.7	30.9	-3.0	26.8	-13.5	1.4	33.8	9.9	33.0	69.2	58.7	42.0	82.1
Gross foreign assets	81.3	123.7	84.8	119.3	73.1	90.4	114.1	...	117.7	163.8	142.2	128.5	166.5
Foreign liabilities	-93.0	-92.8	-87.8	-92.5	-86.6	-88.9	-80.2	...	-84.7	-94.6	-83.5	-86.6	-84.4
Net domestic assets	20,075	13,359	17,515	15,048	16,336	16,103	14,988	17,594	15,520	12,387	13,681	12,734	12,912
Credit to government (net)	19,815	11,237	20,466	12,046	20,002	20,362	17,949	...	22,181	19,415	20,376	17,456	16,474
Credit to statutory bodies (net)	0	0	0	0	0	0	0	...	0	0	0	0	0
Credit to domestic banks	3	2	3	2	3	2	3	...	2	3	2	3	2
Other items (net)	257	2,120	-2,954	3,001	-3,670	-4,261	-2,964	...	-6,663	-7,031	-6,697	-4,726	-3,564
Revaluation accounts	0	59	0	-2	0	0	0	...	0	0	0	0	0
Open market operations	-6,816	-5,937	-9,636	-5,582	-10,071	-13,592	-8,991	...	-16,907	-17,441	-17,483	-15,856	-15,136
Encumbered reserves	1,013	1,013	1,013	1,013	1,013	1,037	1,013	...	800	800	800	800	800
Others	6,060	6,985	5,669	7,572	5,388	8,293	5,014	...	9,445	9,611	9,987	10,331	10,772
Memorandum items:													
Seasonally adjusted reserve money	17,908	16,060	16,884	17,918	18,129	19,745	18,144	18,144	19,590	20,060	20,847	21,818	23,023
Quarterly change	-1.6	-14.3	-5.7	11.6	7.4	10.2	0.1	0.1	-0.8	2.4	3.9	4.7	5.5
Annual change	46.4	30.2	25.1	29.8	23.3	34.8	-0.3	-0.3	4.6	24.9	16.3	10.5	17.5
Seasonally adjusted currency outside banks	...	10,777	...	11,632	...	11,864	...	...	...	...	...	...	...
Quarterly change	...	8.1	...	7.9	...	2.0	...	...	...	...	...	...	...
Annual change	...	41.0	...	40.2	...	38.8	...	...	...	...	...	...	...
Money multiplier													
Money multiplier	2.34	2.60	2.57	2.54	2.84	2.75	2.68	2.68	2.62	2.51	2.54	2.83	2.64
Seasonally adjusted	2.40	2.64	2.60	2.56	2.60	2.48	2.60	2.60	2.53	2.55	2.55	2.55	2.55
Net sales 2/													
Quarterly change	5,077	6,643	2,820	-2,254	435	6,041	-1,080	...	1,952	2,517	-735	-507	1,269
Annual change	9,412	11,944	9,919	7,378	9,034	12,098	7,252	...	12,383	8,257	9,776	3,228	2,545

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

1/ Adjusted for a shortfall in BoP support (WB $25 million) as stipulated in the SMP TMU.
2/ Defined as the increase in holdings at cost value of both treasury and RBM bills in the private sector.

Table 3b. Malawi : Monetary Survey, 2004-06
(In millions of Malawi kwacha, unless otherwise indicated)

	2004				2005						2006	
	Q3		Q4		Q1		Q2		Q3	Q4	Q1	Q2
	SMP	Act.	SMP	Act.	SMP	Act.	SMP	Proj.	Proj.	Proj.	Proj.	Proj.
Money and quasi-money	44,044	43,452	44,164	45,666	42,218	44,552	49,998	51,214	52,347	53,010	50,689	60,691
Money	...	24,556	...	25,443	...	24,400	...	...	...	...	...	...
Quasi money	...	18,896	...	20,222	...	20,151	...	...	...	...	...	...
Of which: foreign currency deposits	...	7,501	...	7,120	...	7,284	...	...	...	...	...	...
Net foreign assets (NFA)	4,911	9,358	6,082	7,593	4,496	2,539	10,960	7,197	13,083	12,512	10,882	18,096
NFA (in millions of U.S. dollars)	45.1	85.9	55.8	69.7	41.3	23.4	100.6	58.5	106.4	101.7	88.5	147.1
Gross foreign assets	156.4	200.1	163.9	177.8	148.2	120.8	201.2	150.3	211.6	199.4	190.7	248.7
Foreign liabilities	-111.3	-114.2	-108.1	-108.1	-106.9	-97.5	-100.5	-91.8	-105.2	-97.7	-102.3	-101.6
Monetary authorities	-1,275	3,369	-322	2,919	-1,472	93	3,685	4,061	8,507	7,223	5,162	10,101
NFA of the monetary authorities (in millions of U.S. dollars)	-11.7	30.9	-3.0	26.8	-13.5	1.4	33.8	33.0	69.2	58.7	42.0	82.1
Gross foreign assets	81.3	123.7	84.8	119.3	73.1	90.4	114.1	117.7	163.8	142.2	128.5	166.5
Foreign liabilities	-93.0	-92.8	-87.8	-92.5	-86.6	-88.9	-80.2	-84.7	-94.6	-83.5	-86.6	-84.4
Commercial banks	6,186	5,989	6,404	4,674	5,968	2,446	7,275	3,137	4,576	5,289	5,720	7,995
NFA of the commercial banks (in millions of U.S. dollars)	56.8	55.0	58.8	42.9	54.8	21.9	66.8	25.5	37.2	43.0	46.5	65.0
Gross foreign assets	75.1	76.5	79.1	58.5	75.1	30.5	87.1	32.6	47.8	57.2	62.2	82.2
Foreign liabilities	-18.3	-21.5	-20.3	-15.6	-20.3	-8.5	-20.3	-7.1	-10.6	-14.2	-15.7	-17.2
Net domestic assets	39,133	34,094	38,083	38,073	37,722	42,012	39,038	44,017	39,264	40,498	39,807	42,594
Credit to government (net)	30,865	23,232	31,516	22,322	31,052	29,294	28,999	30,887	30,104	30,288	28,489	29,496
Credit to statutory bodies (net)	-752	-606	-786	-483	-814	-664	-842	-665	-879	-694	-917	-724
Credit to private sector	10,362	11,942	10,660	13,926	11,923	13,227	13,428	14,914	15,325	16,356	15,716	16,142
Other items (net)	-1,342	-474	-3,307	2,307	-4,439	156	-2,547	-1,119	-5,287	-5,453	-3,482	-2,320
RBM's revaluation accounts	0	59	0	-2	0	0	0	0	0	0	0	0
Open market operations	-6,134	-5,639	-7,708	-5,372	-8,560	-5,782	-6,293	-7,970	-12,304	-12,846	-11,220	-10,499
Encumbered reserves	1,013	1,013	1,013	1,013	1,013	1,037	1,013	800	800	800	800	800
Others	3,779	4,092	3,388	6,668	3,108	4,900	2,733	6,052	6,218	6,594	6,939	7,379
Memorandum items:												
Seasonally adjusted broad money	42,667	42,126	44,587	45,614	46,148	48,556	47,763	48,641	50,749	52,950	55,245	57,641
Quarterly change	4.5	3.8	4.5	8.3	3.5	6.5	3.5	0.2	4.3	4.3	4.3	4.3
Annual change	30.0	28.3	25.5	29.3	18.0	24.5	17.0	19.8	20.5	16.1	13.8	18.5
Seasonally adjusted credit to private sector	10,152	12,151	10,863	13,543	11,916	13,654	13,457	15,288	15,594	15,906	16,224	16,548
Quarterly change	-2.7	13.3	7.0	11.5	9.7	0.8	12.9	12.0	2.0	2.0	2.0	2.0
Annual change	11.9	34.6	12.9	42.3	24.8	39.4	28.9	42.6	28.3	17.4	18.8	8.2
Velocity of money (annual GDP divided by seasonally adjusted end-period broad money)	4.57	4.66	4.55	4.49	4.57	4.40	4.58	4.58	4.57	4.55	4.57	4.58

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

Table 4a. Malawi: Balance of Payments, 2001-08 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004		2005	2006	2007	2008
	Act.	Prel.	Prel.	SMP	Prel.	Proj.	Proj.	Proj.	Proj.
Current account balance (including grants)	-116.8	-216.2	-134.2	-165.1	-149.5	-118.7	-66.0	-109.7	-136.7
Trade balance	-158.0	-305.7	-351.0	-226.6	-395.8	-447.3	-392.1	-438.2	-460.5
Exports	426.6	421.1	440.6	476.4	470.4	536.4	571.5	591.0	617.3
Imports	-584.5	-726.8	-791.6	-703.0	-866.2	-983.7	-963.6	-1,029.3	-1,077.8
Services balance	-66.3	-154.0	-88.2	-74.8	-84.6	-81.8	-89.0	-91.8	-93.8
Interest public sector (net)	-17.8	-20.2	-25.5	-24.1	-27.7	-23.8	-23.6	-21.3	-18.6
Receipts	8.7	2.5	1.5	1.3	0.7	0.6	4.6	6.2	8.2
Payments (amounts due before HIPC debt relief)	-26.5	-22.7	-27.0	-25.4	-28.4	-24.4	-28.2	-27.5	-26.8
Other factor payments (net)	-15.3	-24.5	-16.1	-15.7	-16.8	-17.1	-18.5	-19.6	-20.7
Nonfactor (net)	-33.2	-109.3	-46.6	-35.0	-40.1	-40.9	-46.9	-51.0	-54.4
Unrequited transfers (net)	107.5	243.4	305.1	136.3	330.9	410.4	415.1	420.3	417.6
Private (net)	9.7	8.1	141.1	12.7	117.6	131.4	134.1	136.7	139.5
Receipts	21.6	21.6	156.4	28.2	127.8	141.7	144.6	147.5	150.5
Payments	-11.8	-13.4	-15.3	-15.5	-10.2	-10.4	-10.6	-10.8	-11.0
Official (net)	97.7	235.3	164.0	123.7	213.3	279.0	281.1	283.7	278.1
Receipts	98.3	235.3	164.0	123.7	213.3	279.0	281.1	283.7	278.1
Balance of payments assistance	51.0	12.8	41.7	62.6	64.3	89.9	86.5	80.4	74.4
Japan HIPC Initiative 2/	0.0	11.0	16.8	0.0	0.0	0.0	0.0	0.0	0.0
Donor humanitarian grants	0.0	135.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project related	47.3	76.1	87.5	61.0	149.0	175.6	194.5	203.2	203.7
Drought related	0.0	0.0	0.0	0.0	0.0	13.6	0.0	0.0	0.0
Food security	0.0	0.0	18.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account balance (incl. errors and omissions)	85.3	59.7	93.9	130.7	124.2	98.5	84.1	89.9	105.0
Medium- and long-term flows	59.8	23.8	10.9	56.8	16.2	56.8	25.6	23.0	34.4
Disbursements	127.0	81.0	96.7	131.6	95.3	122.7	103.9	103.9	112.7
Balance of payments support	55.0	0.0	18.4	35.6	35.2	43.3	31.5	31.5	35.3
Project support	72.0	81.0	78.3	86.0	50.1	79.4	72.4	72.4	77.4
Other medium-term loans				10.0	10.0	0.0	0.0	0.0	0.0
Other investment assets	0.0	0.0	-17.2	2.9	-4.3	0.0	0.0	0.0	0.0
Amortization (amounts due before HIPC debt relief)	-67.2	-57.2	-68.6	-77.6	-74.8	-65.9	-78.3	-80.8	-78.3
Foreign direct investment and other inflows	28.0	37.6	43.2	44.1	44.1	26.5	29.7	32.2	33.8
Short-term capital and errors and omissions	-2.5	-1.7	39.8	29.8	63.9	15.2	28.8	34.7	36.8
Overall balance	-31.6	-156.5	-40.2	-34.4	-25.3	-20.2	18.1	-19.8	-31.7
Financing (- increase in reserves)	31.5	156.5	40.2	34.4	25.3	20.2	-18.0	19.8	9.6
Central bank	11.8	111.4	-0.6	7.2	-15.7	-29.1	-70.5	-26.0	-41.7
Gross reserves (- increase)	40.7	40.8	41.4	29.2	-6.0	-20.1	-68.6	-23.0	-40.8
Liabilities	-28.9	70.6	-42.0	-22.0	-9.7	-9.1	-1.9	-2.9	-0.9
Of which: IMF (net)	-6.0	16.8	-0.1	-14.4	-13.7	-10.5	-2.1	-3.0	-0.9
Purchases/drawings	0.0	23.0	9.3	0.0	0.0	8.3	25.3	17.5	7.3
Repurchases/repayments	-6.0	-6.2	-9.3	-14.4	-13.7	-18.8	-27.3	-20.5	-8.2
Bridge loan	0.0	50.0	-50.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	-7.7	14.5	-6.7	-21.9	-6.0	-0.1	-7.0	-11.0	-4.0
Debt relief	27.4	30.6	47.5	49.1	47.0	49.5	59.4	56.7	55.3
Residual financing gap (+ underfinanced)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	22.1
Memorandum items:									
Gross official reserves									
In millions of U.S. dollars	203.2	162.3	122.9	91.5	128.9	149.0	217.6	240.6	281.4
In months of imports 3/	3.0	2.2	1.6	1.4	1.5	1.7	2.3	2.5	2.7
In months of imports 4/	3.6	2.4	1.7	1.4	1.6	1.7	2.5	2.6	2.9
Usable gross official reserves 5/									
In millions of U.S. dollars	184.6	103.4	115.6	84.8	119.3	142.2	210.8	233.8	274.6
In months of imports 3/	2.8	1.4	1.5	1.3	1.3	1.6	2.3	2.4	2.6
In months of imports 4/	3.3	1.5	1.6	1.3	1.5	1.6	2.4	2.5	2.8
Current account balance (percent of GDP)									
Excluding official transfers	-12.5	-23.3	-16.9	-16.2	-19.3	-20.0	-16.6	-17.5	-17.1
Including official transfers	-6.8	-11.2	-7.6	-9.2	-8.0	-6.0	-3.2	-4.9	-5.6
Export value growth (in percent)	6.2	-1.3	4.6	18.5	6.8	14.0	6.5	3.4	4.4
Import value growth, excluding maize (in percent)	6.2	1.1	34.2	11.7	7.2	15.9	-2.0	6.8	4.7

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

1/ The implications of the recent proposal from the G8 for debt cancellation and the recently approved IDA14 replenishment, which will increase the grant component, have not been incorporated.
2/ For 2002-03, relief was provided through grants in yen. From 2004 onward, debt will be written off and recorded under debt relief.
3/ In months of following year's imports of goods and nonfactor services.
4/ In months of current year's imports of goods and nonfactor services.
5/ Excludes open letter of credit for 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.

Table 4b. Malawi: Gross Financing Requirements and Sources of Financing, 2001-08
(In millions of U.S. dollars)

	2001 Act.	2002 Prel.	2003 Prel.	2004 Prel.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
Gross financing requirements	**-278.3**	**-405.8**	**-383.3**	**-459.3**	**-501.2**	**-528.1**	**-528.7**	**-546.1**
External current account deficit (excl. official transfers)	-215.2	-451.6	-298.1	-362.8	-397.7	-347.0	-393.4	-414.8
of which Trade balance on goods and services	-191.1	-415.0	-397.7	-435.9	-488.2	-438.9	-489.2	-514.9
Official debt amortization	-73.3	-63.4	-77.9	-88.5	-84.7	-105.7	-101.4	-86.6
of which IMF repurchases and repayments	-6.0	-6.2	-9.3	-13.7	-18.8	-27.3	-20.5	-8.2
Other , including reserves	10.1	109.1	-7.2	-8.0	-18.7	-75.4	-34.0	-44.8
Gross reserves	40.7	40.8	41.4	-6.0	-20.1	-68.6	-23.0	-40.8
Gross liabilities (excluding IMF)	-22.8	53.8	-41.9	4.0	1.5	0.1	0.1	0.0
Change in n.f.a. of commercial banks	-7.7	14.5	-6.7	-6.0	-0.1	-7.0	-11.0	-4.0
Sources of financing	**278.3**	**405.8**	**383.3**	**459.3**	**501.2**	**528.2**	**528.7**	**524.1**
Private capital (net)	25.5	35.9	65.8	103.7	41.7	58.5	66.9	70.6
of which Short term errors and ommissions	-2.5	-1.7	39.8	63.9	15.2	28.8	34.7	36.8
Gross official Assistance	225.3	339.3	270.0	308.6	410.0	410.2	405.1	398.1
Official Grants	98.3	235.3	164.0	213.3	279.0	281.1	283.7	278.1
Balance of payments support	51.0	12.8	41.7	64.3	89.9	86.5	80.4	74.4
Other	47.3	222.5	122.3	149.0	189.2	194.5	203.2	203.7
Loan Disbursements	127.0	104.0	106.0	95.3	131.0	129.2	121.4	120.0
IMF	0.0	23.0	9.3	0.0	8.3	25.3	17.5	7.3
Balance of payments support	55.0	0.0	18.4	35.2	43.3	31.5	31.5	35.3
Project support	72.0	81.0	78.3	50.1	79.4	72.4	72.4	77.4
Other medium-term loans	0.0	0.0	0.0	10.0	0.0	0.0	0.0	0.0
Accumulation of arrears (exceptional)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	27.4	30.6	47.5	47.0	49.5	59.4	56.7	55.3
Financing gap (surplus +/deficit -)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-22.1**
Memorandum items (percent of GDP)								
Gross financing requirements	-16.2	-20.9	-21.6	-22.9	-24.0	-23.5	-21.8	-20.8
Current account balance, excluding official transfers	-12.5	-23.3	-16.8	-18.1	-19.1	-15.5	-16.2	-15.8
Trade balance on goods and services	-11.1	-21.4	-22.4	-21.8	-23.4	-19.5	-20.2	-19.6
Gross official assistance	13.1	17.5	15.2	15.4	19.6	18.3	16.7	15.2
Gross official assistance, net of amortization after debt relief	10.5	15.8	13.5	13.3	18.0	16.2	14.9	14.0
Balance of payments assistance (including IMF)	6.2	1.8	3.9	5.0	6.8	6.4	5.3	4.5
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.8

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

Table 5a. Malawi: Quantitative Targets for FY2004/05 1/

	Jun-04	Cumulative Flows from June 30, 2004							
		End-Sep.			End-Dec.			End-Mar.	
	Stock Actual	Target	Adjusted target	Actual	Target	Adjusted target	Actual	Target	Actual
	(In millions of Malawi kwacha)								
1. Ceiling on net domestic assets of the monetary authorities 2/	18,731	1,344	-1,671	-5,371	-1,216	-1,697	-3,682	-2,396	-2,690
2. Ceiling on central government's net domestic borrowing 2/	47,104	6,060	3,046	892	6,711	6,230	-198	6,247	6,151
3. Ceiling on central government wages and salaries 3/	...	3,400	...	3,228	7,300	...	7,775	11,236	12,346
4. Ceiling on central government discretionary expenditures 3/	...	8,278	...	6,372	20,126	...	15,389	28,071	27,626
	(In millions of U. S. dollars)								
5. Floor on net foreign assets of the monetary authorities 2/	-0.1	-11.6	16.1	31.0	-2.9	1.5	26.9	-13.4	1.5
6. Ceiling on the accumulation of external payments arrears 4/	...	0.0	...	0.0	0.0	...	0.0	0.0	0.0
7. Ceiling on the contracting or guaranteeing of nonconcessional external debt with original maturities of over one year by the central government, the RBM or other agencies on behalf of the central government. 4/ 5/	...	10.0	...	10.0	10.0	...	10.0	10.0	10.0
8. Ceiling on the contracting or guaranteeing of nonconcessional external debt with original maturities of one year, or less, by the central government, the RBM or other agencies on behalf of the central government. 4/	...	0.0	...	0.0	0.0	...	0.0	0.0	0.0
Memorandum item:									
Baseline for balance of payments support	...	0.0	...	27.7	58.0	...	62.4	84.7	62.4

1/ Targets are defined in the technical memorandum of understanding (TMU).
2/ Targets are subject to an adjuster for balance of payment support.
3/ Targets are subject to an adjuster for donor-funded health expenditures.
4/ Evaluated on a continuous basis.
5/ Loan contracted following an agreement by the previous government to purchase communication equipment for the Ministry of Defense.

Table 5b. Malawi: Structural Benchmarks Under the Staff-Monitored Program

	Measure	Implementation Date	Status
I. Public Expenditure Management			
1	Activate the credit ceiling module to reject all payments in excess of credit ceilings.	End-January 2005	Completed, but further follow up is necessary.
2	Submit the 2003/04 public accounts to the Public Accounts Committee of parliament.	End-February 2005	Completed with a delay.
3	Install CCA/reimbursement reporting software on computers of key MOF officials. Arrange for appropriate training.	End-January 2005	Completed
4	The Accountant General (AG) will regularly review the maintenance of ledgers, CCS system, and record keeping in line ministries. The AG will develop an inspection program outlining ministries to be visited from January to June (3-5 ministries per month). After each visit, the AG will prepare a short report on major findings, actions to be taken, and a timeline for follow-up.		
	Inspection program (timetable)	End-January 2005	Completed
	Summary reports	Every month	On going
5	Institute a management reporting system of weekly reports on CCAs, supplementary CCAs, and reimbursement, by ministry and expenditure category, to be submitted to senior staff in the Treasury, the Accountant General's office and the Reserve Bank of Malawi.	End-January 2005	Completed, but further follow up is necessary.
6	Present to Cabinet statement on economic and financial policies for the FY 2005/06 budget.	End-April 2005	Completed
7	Present to parliament draft budget for FY 2005/06 consistent with macro framework agreed with the IMF	End-June 2005	Completed
II. Arrears			
8	Produce list of central government arrears.	End-May 2005	Completed
9	Produce list of arrears to the central government.	End-May 2005	Delayed
10	Formulate policy for verification and repayment of arrears.	End-June 2005	Completed
11	Prepare monthly arrears report on the basis of the CCS system.	End-April 2005	Delayed
III. PRSP Implementation			
12	Complete draft of second Annual Progress Report (APR) and submit to IMF and World Bank staff. Draft should incorporate revised growth strategy and medium-term macro projections.	End-January 2005	Completed

Table 6a: Malawi: Schedule of Disbursements Under the Proposed Three-Year PRGF Arrangement
(In million of SDRs)

Amount	Date	Conditions Necessary for Disbursement
5.4190	Jul-05	Executive Board approval of three-year PRGF arrangement
4.9245	Feb-06	Completion of 1st review and observance of end-Sep. 2005 Performance Criteria
4.9245	May-06	Completion of 2st review and observance of end-Dec. 2005 PCs
6.6800	Nov-06	Completion of 3nd review and observance of end-Mar. and end-Jun. 2006 PCs
6.6800	May-07	Completion of 4rd review and observance of end-Dec. 2006 PCs
4.7710	Nov-07	Completion of 5th review and observance of end-Jun. 2007 PCs
4.7710	May-08	Completion of 6th review and observance of end-Dec 2008 PCs
38.1700 1/		

1/ Equivalent to 55 percent of Malawi's quota (SDR 69.4 million).

Table 6b: Malawi: Indicators of Fund Credit, 2004 - 2015
(In millions of SDRs, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Fund credit outstanding 1/												
In millions of SDRs	59.5	52.6	51.3	49.3	48.7	44.6	42.0	38.7	32.3	23.9	16.3	8.6
In millions of U.S. dollars	90.0	80.0	78.0	75.0	74.1	67.8	63.8	58.7	49.1	36.3	24.7	13.1
In percent of quota	85.8	75.8	73.9	71.1	70.2	64.3	60.6	55.7	46.6	34.4	23.4	12.4
Existing stock												
In millions of SDRs	59.5	47.2	29.3	15.9	10.5	6.4	3.9	2.6	1.3	0.0	0.0	0.0
In millions of U.S. dollars	90.0	71.8	44.6	24.2	16.0	9.8	5.9	3.9	2.0	0.0	0.0	0.0
In percent of quota	85.8	68.0	42.2	22.9	15.2	9.3	5.6	3.7	1.9	0.0	0.0	0.0
Proposed disbursement												
In millions of SDRs	0.0	5.4	16.5	11.5	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In millions of U.S. dollars	0.0	8.2	25.2	17.4	7.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In percent of quota	0.0	7.8	23.8	16.5	6.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund obligations	9.9	13.4	18.8	14.1	5.9	4.6	3.1	3.8	6.8	8.9	8.0	7.9
Fund total charges and interest 2/	0.7	1.0	0.9	0.6	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.3
Existing drawings	0.7	1.0	0.9	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2
Prospective drawings	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Fund total repayment/repurchase /3	9.2	12.4	17.9	13.4	5.4	4.1	2.6	3.4	6.3	8.4	7.6	7.6
Existing drawings	9.2	12.4	17.9	13.4	5.4	4.1	2.6	1.3	1.3	1.3	0.0	0.0
Prospective drawings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.1	5.1	7.2	7.6	7.6
Net Fund credit	-9.2	-6.9	-1.3	-2.0	-0.6	-4.1	-2.6	-3.4	-6.3	-8.4	-7.6	-7.6
Net use of Fund resources	-9.9	-8.0	-2.3	-2.6	-1.1	-4.6	-3.1	-3.8	-6.8	-8.9	-8.0	-7.9
Fund credit outstanding in percent of												
Exports of good and nonfactor services	17.6	13.9	12.7	11.8	11.2	9.8	8.8	7.7	6.1	4.3	2.8	1.4
Gross official reserves	75.4	53.7	37.5	32.5	27.3	22.7	19.0	15.5	11.3	6.9	4.5	2.3
Fund obligations in percent of												
Exports of good and nonfactor services	2.9	3.5	4.7	3.4	1.4	1.0	0.6	0.8	1.3	1.6	1.4	1.3
Gross official reserves	12.6	13.7	13.8	9.3	3.3	2.3	1.4	1.5	2.4	2.6	2.2	2.1
Memorandum items:												
Quota (in millions of SDR)	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4
Export of goods and nonfactor services (in millions of U.S. dollars)	511	578	614	634	662	694	727	764	803	845	890	937
Gross official reserves (in millions of U.S. dollars)	119	149	208	231	271	298	337	380	436	524	551	578

Sources: Malawi authorities; and Fund staff estimates and projections

1/ Includes the prospective disbursement under the Poverty Reduction and Growth Facility arrangement for a total of SDR 38.2m (55 percent of quota) and the repurchase of of the outstanding General Resources Account drawings under the IMF's policy on emergency assistance for natural disasters.
2/ Before the subsidization of charges.
3/ Excludes HIPC assistance

Table 7a. Malawi: Millennium Development Goals

	1990	1995	2001	2002
1. Eradicate extreme poverty and hunger (2015 target = halve 1990 $1 a day poverty and malnutrition rates)				
Population below $1 a day (%)	...	...	...	...
Poverty gap at $1 a day (%) 1/	...	14.8	...	...
Percentage share of income or consumption held by poorest 20%	...	4.9	...	...
Prevalence of child malnutrition (% of children under 5)	27.6	29.9	25.4	...
Population below minimum level of dietary energy consumption (%)	49.0	39.0	33.0	...
2. Achieve universal primary education (2015 target = net enrollment to 100)				
Net primary enrollment rate (% of relevant age group)	49.7	99.0	...	...
Percentage of cohort reaching grade 5 (%)	64.5	34.2	...	...
Youth literacy rate (% ages 15-24)	63.2	67.3	71.8	72.5
3. Promote gender equality (2015 target = education ratio to 100)				
Ratio of girls to boys in primary and secondary education (%)	81.1	88.4	...	...
Ratio of young literate females to males (% ages 15-24)	67.6	71.4	76.0	76.7
Share of women employed in the nonagricultural sector (%)	10.5	11.3	12.2	...
Proportion of seats held by women in national parliament (%)	...	6.0	...	...
4. Reduce child mortality (2015 target= reduce 1990 under 5 mortality by two-thirds)				
Under-5 mortality rate (per 1,000)	241	216	188	182
Infant mortality rate (per 1,000 live births)	146	133	117	113
Immunization, measles (% of children under 12 months)	81	90	82	69
5. Improve maternal health (2015 target = reduce 1990 maternal mortality by three-fourths)				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	1,800	...
Births attended by skilled health staff (% of total)	54.8	...	55.6	...
6. Combat HIV/AIDS, malaria, and other diseases (2015 target = halt, and begin to reverse AIDS etc.)				
Prevalence of HIV, female (% ages 15-24)	...	...	14.9	...
Contraceptive prevalence rate (% of women ages 15-49)	13.0	22.0	30.6	...
Number of children orphaned by HIV/AIDS (thousands)	...	...	470	...
Incidence of tuberculosis (per 100,000 people)	...	...	432	431
Tuberculosis cases detected under DOTS (%)	...	39	40	36
7. Ensure environmental sustainability				
Forest area (% of total land area)	35.2	...	27.6	...
Nationally protected areas (% of total land area)	...	11.3	11.3	11.3
GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	...
Access to an improved water source (% of population)	49	...	57	...
Access to improved sanitation (% of population)	73	...	76	...
Access to secure tenure (% of population)	...	...	...	...
8. Develop a Global Partnership for Development				
Youth unemployment rate (% of total labor force ages 15-24)	...	...	...	...
Fixed line and mobile telephones (per 1,000 people)	3.1	3.7	10.6	15.2
Personal computers (per 1,000 people)	...	...	1.3	1.3

Source: *World Development Indicators database, 2004* and *http://www.developmentgoals.org.*
1/ 1998.

Table 7b. Malawi: Selected Social and Demographic Indicators

	Malawi, Latest Single Year			Sub-Saharan	Low-Income
	1970-75	1980-85	1995-2003	Africa	Countries
Population					
Total population (millions)	5.2	7.3	11.0	688.9	2,494.6
Growth rate (annual average for period)	3.0	3.2	2.1	2.5	1.9
Urban population (percent of population)	7.7	10.3	15.5	33.1	30.6
Total fertility rate (births per woman)	7.5	7.5	6.1	5.1	3.5
Poverty (percent of population) 1/					
National	...	...	65.3	...	...
Urban	...	...	54.9	...	...
Rural	...	...	66.5	...	...
Income 2/					
GNI per capita (*World Bank Atlas* method; U.S. dollars)	130	160	160	450	430
GNI per capita (PPP - current international dollars)	200	370	570	1,700	2,110
Consumer price index (1995=100)	...	9.9	533.8	...	...
Food price index (1995=100)	...	8.4	477.5	...	...
Income/consumption distribution					
(share of income or consumption)					
Gini index	...	...	50.3	...	...
Lowest quintile (percent of income or consumption)	...	...	4.9	...	...
Highest quintile (percent of income or consumption)	...	...	56.1	...	...
Public expenditure					
Health (percent of GDP)	...	...	7.8	6.0	4.4
Education	2.5	3.3	4.1	3.4	2.5
Social security and welfare	...	...	...	...	...
Access to improved water source (percent of population)					
Total	...	...	57.0	58.2	75.7
Urban	...	...	95.0	82.8	89.7
Rural	...	...	44.0	46.5	69.9
Immunization rate (percent under 12 months)					
Measles	...	49.0	69.0	57.6	64.7
DPT	...	55.0	64.0	53.7	64.6
Child malnutrition (percent under 5 years)	...	23.9	25.4	...	41.7
Life expectancy at birth (years)					
Total	42.2	45.5	37.5	45.8	58.9
Male	41.5	44.8	37.1	46.6	57.9
Female	42.9	46.3	38.0	45.1	59.8
Mortality					
Infant (per 1,000 live births)	189.0	157.0	113.0	103.1	78.6
Under 5 (per 1,000 live births)	330.0	265.0	182.0	173.9	120.8
Adult (15-59)					
Male (per 1,000 population)	479.4	428.6	701.0	519.5	310.5
Female (per 1,000 population)	387.9	348.6	653.0	461.1	259.1
Births attended by skilled health staff (percent)	...	...	55.6	...	...

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

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

July 18, 2005

Mr. Rodrigo de Rato y Figaredo
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. de Rato:

1. Malawi's previous PRGF arrangement expired in December 2004. Because of slippages in macroeconomic policy implementation, we requested a staff-monitored program (SMP) in September 2004 to help us restore sound financial policies, make progress with our structural reform program, and to establish a performance track record to enable us to move to a new PRGF arrangement. We believe that performance under the SMP has been strong. In addition, we have completed the two prior actions (Table 2) for moving to a PRGF arrangement and have dropped informal administrative restrictions on foreign exchange transactions.

2. On the basis of performance under the SMP, we now request a new PRGF arrangement with the Fund in the amount of SDR 38.17 million (55 percent of quota) and additional interim assistance under the enhanced HIPC initiative of SDR 4.628 million. In view of the continuing fragility of macroeconomic conditions in Malawi, we request that, during the first year of the program, it be monitored based on quarterly performance criteria with semi-annual reviews and disbursements as specified in table 3 of the MEFP. We anticipate the first review—based on performance as of end-September 2005—to take place in February 2006 and the second review—based on performance as of end-December 2005—in May 2006.

3. The attached memorandum of economic and financial policies (MEFP) describes Malawi's economic and financial policies for 2005/06 (July-June). The program is derived from the Malawi poverty reduction strategy paper (MPRSP), updated in the recent Annual Progress Report (APR), and builds on the policy measures under the staff monitored program. The MEFP also updates the macroeconomic framework in the MPRSP and APR. Successful implementation of policies supported by the PRGF arrangement will be essential to allow Malawi to reach the Completion Point under the enhanced HIPC Initiative and to help achieve the MDGs.

4. The government of Malawi believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it is prepared to implement additional steps that may become appropriate for this purpose. Malawi will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation.

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

Sincerely yours,

/s/	/s/
Goodall Gondwe Minister of Finance	Victor Mbewe Governor Reserve Bank of Malawi

Attachments

MALAWI

Memorandum of Economic and Financial Policies of the Government of Malawi

July 18, 2005

I. Introduction

1. In May 2004, the newly elected President Bingu wa Mutharika adopted a policy of zero tolerance for corruption. His insistence on the rule of law has set the stage for a new era of sound governance and prudent economic policies.

2. Our macroeconomic performance improved markedly since the new government took office. We have restored fiscal discipline and put an end to runaway borrowing, refined our plans to reduce poverty through growth and wealth creation, and have taken significant steps to address our most pressing health issues. In July 2004, we requested a Staff-Monitored Program (SMP) with the IMF as a means of demonstrating our commitment to the principles of sound economic policies. On the basis of strong performance against the September financial targets established in the SMP, our key development partners restarted their budget support programs.

3. With the continued strong performance through end-March 2005 and good prospects for the remainder of the financial year, we request a new Poverty Reduction and Growth Facility arrangement with the IMF, and additional interim assistance under the enhanced HIPC initiative. We note that key budget and monetary targets for end-March were observed, in large part because all government ministries stayed within their budget provisions for the first time in a number of years. We also implemented changes in our procedures aimed at improving expenditure management and we now publish our monthly fiscal data on the internet. We believe that this turnaround in budget management and efforts to keep the people of Malawi informed on their government's finances demonstrates our commitment to sound economic policies.

II. Recent Developments

4. Economic growth accelerated in 2004, in large part due to strong tobacco production. While a positive step, our economy will need to expand more quickly and provide more employment opportunities if we are to see significant reductions in our poverty rate. We will achieve this in coming years as our strategies and steadfast policy implementation take hold. The monetary expansion that was a legacy of excessive government borrowing during the last financial year added to price pressures. Our external current account deficit (including grants) widened during 2004, despite a large increase in tobacco production, as auction sales and processing were delayed for technical reasons.

Imports increased as can be expected in a growing economy, by 5 percent, above the real GDP growth. Higher world petroleum and fertilizer prices also added to our import bill. Nevertheless, we maintained our foreign reserve cover at 1.4 month of imports (of the following year), a figure that will need to be increased in the future.

5. Regrettably, food security has become a too frequent problem. A dry spell at the end of the 2004/05 crop season, which was already below normal, reduced our maize crop by an estimated 25 percent, resulting in an estimated need to import 250,000 tons of maize by government and the private sector—though this estimate may be revised. The incomes of many households have been cut or eliminated, making a sharp increase in humanitarian aid necessary. We are currently looking at ways to restore our food security, both in the near and medium-term horizons.

III. THE MEDIUM-TERM REFORM STRATEGY (BOX 1)

6. The Government of Malawi is committed to sound economic and financial policies. r. In the past, Malawi was considered a model of efficiency and good practice, and food security was less a concern. We must, and we can, restore good financial management and create the environment in which the private sector can lead in wealth creation and growth.

7. Our guiding principles in the economic area are domestic debt repayment, the rebuilding of public expenditure management and procurement, and a private sector orientation to our policies. Steadfast application of these principles will help us achieve the objectives set out in the Malawi Poverty Reduction Strategy in 2002.

A. Achieving the Millennium Development Goals (MDGs)—the Way Forward

8. We must move forward quickly if we are to make meaningful progress toward the MDGs. Reducing poverty and improving the lives of Malawians through access to better health care, education, and food security are at the core of our government. A strong, private sector led economy will be the basis of our progress.

9. We are currently reviewing our strategies outlined in the MPRSP to take into consideration the lessons learned in our two annual reviews and the vision for Malawi outlined by the president in his inaugural address. We have made significant progress in Pillar 1 (pro-poor growth) and are moving forward with Pillars 2-4:

- Our strategy for pro-poor growth (Pillar 1) was updated in the *Malawi Economic Growth Strategy* (MEGS) and places new emphasis on the private sector. This document, which was prepared jointly by the government and the private sector,

Box 1. Structural Reforms in the Medium Term

Our medium term agenda for structural reform is guided by the MPRS with the objective of achieving the MDGs in 2015. To help achieve these broader social objectives, the economic structural reform agenda will include initiatives in three core areas below. The details of these initiatives will be developed over the course of the PRGF arrangement.

A. Improve public governance

- Continued anti-corruption drive in support of zero tolerance for corruption in the public sector.
- Focus on improving governance in public expenditure management, especially public procurement.
- Initiatives on anti-money laundering and fraud protection.

B. Enhancing macroeconomic management

Fiscal

- Continued efforts to enhance public expenditure management, including the implementation of the Tanzanian model for IFMIS, and budget implementation.
- Build on the recent general review of tax policies and tax administration with the overall objective of making the tax system competitive and business friendly.
- Continued civil service reform in the areas of wages, pensions, structure and size.
- Eliminate the large stock of existing commercial arrears and forgo further arrears accumulation.

Monetary

- Review of the exchange rate regime with the objective of ensuring adequate exchange rate stability within an overall market determined environment.
- Move towards granting full independence to the Reserve Bank as part of a SADC wide initiative.
- Strengthen monetary policy instruments and promote money and exchange rate market development.

C. Improving economic efficiency in support of private sector led growth

Business environment

- Strengthen the business environment by introducing a commercial court, streamlining business licensing, and strengthening tax administration.
- Investment in public physical infrastructure—roads, railroads and bridges.
- Negotiations towards entering the COMESA Customs Union in 2007 and the SADC FTA in 2008.
- We are revising the privatization divesture plan and will privatize or commercialize the remaining state enterprises to improve their efficiency and service—especially for power and other public utilities.

Agriculture

- Support agricultural growth by improving the functioning of food markets, including removing practices (through legislation) that restrict free competition in food and input markets.
- Initiatives to bolster non-tobacco exports.

strengthens our reliance on a sound macroeconomic environment to facilitate private sector growth. The government is also reducing the cost of doing business by building and improving roads, and ensuring adequate utilities are provided. Overall, we see growth and wealth creation, especially in rural areas, as a main force in poverty reduction.

- Strategies for human development, improved lives for the most vulnerable, and governance (Pillars 2-4) are currently being enhanced and will reflect our new poverty assessment that is nearing completion. We have already made significant progress in strengthening our health policies through the new health sector wide approach (SWAp) and have made great strides in the area of governance.

- We intend to hold further consultations on the new development strategy over the coming months and prepare a fully updated strategy by early 2006. We envisage significant changes to the objectives in the MPRSP that take into account the updated growth strategy, new resources in the health sector, measures to make our education system more efficient, and our emphasis on governance.

B. Good Governance

10. We are addressing governance issues in four areas.

- **Zero tolerance for corruption**. We remain committed to the principle of no tolerance for corruption. Public officials and civil servants serve in the public trust and must be held accountable for their actions.

- **Financial governance**. We will push ahead with improvements to public expenditure management, civil service wage and pension reforms, procurement, and budget implementation. We will continue to strengthen financial management in Malawi's remaining parastatals and complete the ongoing review of their governing boards.

- **Economic governance**. The government needs to become more business friendly by making our institutions more efficient, providing better service to our citizens and foreign investors, ensuring that the tax burden is fair, and by reducing subsidies.

- **Political governance**. We will hold local government elections in 2005/06 and general elections in 2009. A new parliament building will be constructed in the next few years to accommodate the consolidation of government in Lilongwe.

C. Macro Environment

11. A stable macroeconomic environment is essential for private sector business development, but also for the well-being of the population. Inflation hurts the poor more

than others as they lack means of protecting savings and earnings from higher prices. Predictable, market-determined interest and exchange rates allow businesses to plan investment strategies without fear of sharp swings in these key variables.

12. We are committed to addressing constraints to economic growth. As outlined in the Malawi Economic Growth Strategy, transport bottlenecks, including intra-regional, create frequent disruptions in the domestic markets and raise the cost of doing business. We will therefore seek to boost investment in our roads, railroads and bridges. Frequent disruptions of power supply is a major concern for our business community, and we are pursuing options to streamline the operations of ESCOM, including clearing arrears to and from other government entities. We are also pursuing regional power arrangements, including the interconnector to Cahorra Bassa hydroelectric plant in Mozambique.

13. Our public institutions do not always provide the best service to our people and businesses. We are therefore improving our court system, including the introduction of a commercial court, working to streamline business licensing, and strengthening tax administration. These steps will help us achieve an economic environment that is competitive within the region and globally.

14. The availability of financial services at reasonable costs will be critical to private sector growth. We will maintain a healthy banking system through close supervision and strive to bring down costs by providing needed infrastructure such as an efficient payments system. We will also continue to strengthen our monetary policy instruments and promote money and foreign exchange market development. Anti-money laundering and fraud protection are also key objectives.

15. Most Malawians live in rural areas and do not have access to credit. Several NGOs are addressing this problem through micro credit projects, but they do not have the adequate capital to reach all areas. Government has therefore decided to establish a rural credit scheme, the Malawi Rural Development Fund (MARDEF), using the Malawi Savings Bank and existing micro credit institutions (Box 2). We are proceeding with caution in view of high default rates in the past and are putting in place specific measures to achieve acceptable loan recovery rates.

16. Our overarching medium-term objective is to raise economic growth and reduce widespread poverty. We anticipate growth to be based on agriculture and agricultural processing because the majority of Malawians are farmers in rural areas. However, investment and investments in the mining, tourism, and construction sectors are expected to result in a growth rate of 6 percent by 2008. We intend to transform the economy from a predominantly consuming and importing to a predominantly producing and exporting one.

The monetary policy objective is stable prices and the monetary authorities will aim to lower inflation to 8 percent and below in the medium term. The external debt situation is expected to improve when the HIPC completion point is reached.

Box 2. Malawi Rural Development Fund (MARDEF)

The government established a microfinance institution, MARDEF, to increase credit in rural areas. The fund will target the production of goods and services by women and youth. Using the Malawi Savings Bank (MSB), a government-owned commercial bank, loans will be between MK 10,000 and MK 100,000. The fund will distribute loans across geographical districts.

The government deposited MK 1 billion in MSB to increase the bank's lending capacity. The additional capacity will be extended to MARDEF. Such an arrangement empowers the rural community to borrow from the financial institution. The government will not earn interest on these deposits. MSB will be encouraged to buy government securities to limit the initial monetary impact of the transfer. MSB will also earmark interest earned on government securities for future MARDEF administrative costs.

MARDEF will adjust the interest charged on loans to reflect operating costs. In addition to administrative costs, MARDEF will incur the following expenses: (i) MARDEF will contract with existing microfinance institutions to assist in preparing and appraising projects, in addition to assisting clients in the formation of groups; and, (ii) MARDEF will pay premiums to insure against default risk. On a monthly basis, the government will review the operations of MARDEF to ensure that the fund is commercially viable.

The government will consider increasing the initial deposit of MK 1 billion to MK 5 billion once MARDEF has demonstrated success, including loan repayment and acceptable operating costs; however, the availability of government funds and the monetary impact will need to be considered in any such decision.

Malawi: Medium Term Macroeconomic Projections, 2002/03-2008/9

	2002/03 Est.	2003/04 Est.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.	2008/09 Proj.
National income and prices							
GDP at constant factor prices	3.0	4.3	3.3	5.2	6.8	5.8	5.9
Nominal GDP (billions of kwacha)	160.1	188.3	222.8	264.0	307.8	351.0	398.8
GDP deflator	15.6	10.5	14.0	13.0	9.2	7.8	7.3
Consumer prices (end of period)	8.6	11.6	14.9	11.0	10.8	7.4	8.1
Central government (percent of GDP)							
Revenue (excluding grants)	20.0	22.7	24.8	24.6	24.4	24.2	24.0
Expenditure	38.3	42.8	42.6	44.7	40.6	39.2	38.4
Domestic interest payment	5.5	9.2	7.4	5.4	4.4	3.3	2.5
Underlying balance	-1.7	-0.9	1.1	1.4	1.9	1.3	0.9
Overall balance	-11.6	-7.8	-4.1	-1.3	-0.9	-0.7	-1.1
Net domestic debt	20.4	25.0	24.1	19.8	16.8	14.2	12.3
Money and credit (change in percent of beginning-of-year M2)							
Money and quasi money	24.1	35.6	19.8	18.5	17.2	15.3	14.9
Velocity	5.3	4.6	4.6	4.6	4.6	4.5	4.5
External sector (millions of U.S. dollars)							
Exports, f.o.b.	422.2	447.7	506.8	544.1	577.5	601.2	630.9
Imports, c.i.f.	-850.6	-770.1	-906.9	-983.8	-1,006.6	-1,036.3	-1,110.0
Useable gross official reserves	89.7	93.5	104.9	163.7	202.4	237.2	242.3

D. Fiscal policy

17. The overarching objective of fiscal policy must be domestic debt reduction. Borrowing over the past several years has pushed our net debt to more than one-quarter of GDP. Servicing costs peaked at over MK 17 billion in 2003/04, nearly one-half of our tax collections. The rise in debt fueled inflation, pushed interest rates up, and reduced resources available to the private sector for productive investment. In the near term we will halt the rise in the ratio of domestic debt to GDP (as was the case in 2004/05), and aim at a reduction in domestic debt to 15 percent of GDP or less by 2008. We feel strongly about this goal and have designated it as a medium-term program target.

18. We have completed a general review of tax policies and tax administration with the overall objective of making our system competitive and business friendly (see below).We

would also like to reduce our overall tax burden, but there is limited room at this point given our current level of spending and our determination to lower our debt burden.

19. Civil service wage and pension costs are high relative to our neighboring countries, given the current GDP figures which are subject to review, and at the same time we have vacancies in key areas such as health. We plan to address these problems in steps, the first of which was implementation of our long-planned civil service wage reform in October 2004. These are medium-term projects that will require time to design and implement. In the near term, we will cap our wage bill, excluding top up payments in the health area that are to be funded with donor assistance, below 8 percent of GDP. To underpin this effort, we are introducing a new payroll system and in the process will complete a census of all who receive a government paycheck.

20. We would like to rationalize and restructure government activities over the medium term to make room for private sector growth. The reduction in the number of government ministers and the President's move from Blantyre to Lilongwe in June 2004 have already begun to produce efficiency gains. Plans for the future are evolving and are outlined below in paragraphs 42 and 43.

21. We are grateful for the assistance being provided by our development partners. In 2004/05, grants account for about one-third of our resources. We will also try to make use of new resource commitments that are currently being discussed by the international community and increase our use of grants while reducing concessional loans. This, and other support, will help us achieve key MDG benchmarks.

22. The priorities set out in the MPRSP and recent update documents will be pursued, subject to our financing constraint. Thus, in the medium term we anticipate dedicating more resources to public infrastructure to strengthen private sector led growth, especially in the rural areas. Education and health are basic rights, and we will ensure that the most vulnerable have access to them. Moreover, an effective education system will help us improve competitiveness and reach our growth objective. We believe that decentralization of the administrative and planning responsibilities will further this effort.

23. We expect that our external and domestic debt service can be lowered to provide more room for priority programs. External debt interest payments are currently around 1½ percent of GDP and will fall somewhat when we reach the HIPC completion point sometime next year and we can benefit from debt cancellation. Our domestic debt service has already begun to come down, but at over 7 percent of GDP in 2004/05, it is far too high and we expect this to fall to near 5 percent of GDP in 2005/06. Our aim is to allow interest rates to come down as our track record of sound fiscal policies is extended and confidence improves. Over time, we will aim to lengthen the maturity structure of our debt stock, making our budget more stable and predictable. We will also look into ways that our development partners could assist with domestic debt reduction.

24. Domestic arrears, or past-due payments for goods and services, are another form of debt. This type of borrowing is unfair to suppliers who become unwilling creditors and to the people of Malawi who must repay these debts that evolved in a nontransparent way. Efforts to address this problem in recent years have proved unsuccessful and the new government has designed and is implementing a strategy to solve this problem once and for all (para. 44).

25. Our strategy to strengthen public expenditure management follows a two-track approach. In the near term, we are restoring the management systems that worked well in the past. This effort includes accurate monthly expenditure returns, respect for funding ceilings, and the application of approved accounting standards. It also involves implementation of our new Public Finance and Auditing Acts. Specific actions are outlined below. Over the next few years, we will be implementing an integrated financial management system (IFMIS) that will anchor our financial management over the medium term. Past efforts towards an IFMIS have not been satisfactory, and we have decided to adopt the system now used in Tanzania.

E. Monetary and Exchange Policy

26. The objective of monetary policy is to bring inflation to 5-8 percent range over the medium term. In this range, inflation would be less likely to distort savings and investment decisions. The RBM will continue to rely on the broad money stock (M2) as the nominal anchor to control inflation. We will use a combination of open market-type operations and foreign exchange sales to influence liquidity conditions. Achieving lower inflation, however, will critically depend on the government's deficit and strictly limiting its borrowing from the RBM.

27. Our medium-term exchange rate objective is to have the kwacha fully market determined and build foreign exchange reserves, but at the same time recognize the importance to businesses of a predictable currency value. We will continue to smooth the exchange rate for seasonal fluctuations, but refrain from attempting to influence its underlying value. We recognize that the most important ingredient for exchange rate stability is sound economic policies, especially prudent fiscal policy. We will strive to increase our level of official international reserves to above three months of import cover, but recognize that current projections show that we may fall short of this target.

28. We intend to move forward toward an independent central bank as part of a SADC-wide initiative. A SADC committee is now preparing model draft legislation, which we will review and adopt if it is appropriate for Malawi. A legally independent RBM could help bolster confidence by lessening the risk of political interference in monetary policy decisions. In preparation, we will review our policy setting and operating procedures at the RBM.

F. External Policies

29. Malawi's reliance on tobacco as the main export and high dependence on imports leave us vulnerable to external shocks and local weather conditions. To address these problems we have included in our growth strategy initiatives to bolster non-tobacco exports. Import growth is expected to moderate, but we will continue to depend on our partners for needed commodities (petroleum) and manufactured goods. In the medium term, we expect to continue to depend on grants and foreign concessional loans.

30. Erosion of trade preferences is a serious concern. The pending elimination of the EU sugar regime in 2008 could impact one of our larger industries and our second largest export. Malawi is a member of the LDC Sugar Working Group that is proposing an extension of the adjustment period until 2019. Textile and clothing exports are of lesser importance in our macro economy, but we will monitor closely the expiry of the global quota restrictions on textiles and clothing (December 2004). We will still have a tariff preference under the African Growth and Opportunity Act (AGOA), but it remains to be seen if this will provide a significant competitive advantage.

31. We remain committed to maintain a liberal trade regime. Malawi has eliminated all quantitative restrictions on imports, except for cement from Zimbabwe, and a revised Trade Agreement with Zimbabwe was signed in March 2005. In the context of our negotiations for Common Market for Eastern and Southern Africa (COMESA) Customs Union (2007) and Southern African Development Community Free Trade Area (2008), we will continue to favor lower tariff scenarios. In addition, we will undertake a study on the impact of COMESA Common External Tariff (CET) for the envisaged Customs Union on our industry competitiveness, revenue, and employment.

G. Food Security

32. The objective of our food security policy is to ensure that all Malawians have sufficient food for a healthy and active life. Unfortunately, our dependency on rain fed agriculture, changing weather patterns, growing population, and increased incidence of HIV/AIDS has increased Malawi's vulnerability to food insecurity.

33. Our medium-term agriculture policies will be based on market principles**.** To this end, the government will continue to improve the functioning of markets, including removing practices (through legislation) that restrict free competition in produce, food and input markets. Our strategy is to improve the availability of fertilizer and other inputs at reasonable market prices at the proper time and to ensure farmers have easy access to markets for their products. We are also looking at ways to promote irrigation involving the private sector and local communities, better agricultural research and extension services, and transport and other infrastructure.

H. State Enterprises

34. We have revised our privatization divesture plan. We believe that privatization of some of our remaining state enterprises will bolster their efficiency, improve service, and potentially provide revenue to the government. After a temporary delay to reassure Malawians that the sale of state enterprises has many advantages and that resources will not be wasted, we are ready to proceed with this program. For the others, we are considering alternatives, including public-private partnerships and mergers. Some parastatals will need to be closed, while for others where social concerns are important, commercialization may be the best option.

35. We are making progress in commercializing parts of ADMARC and restructuring it so as to enhance its impact on small-scale agricultural production. We will look at cost efficiencies in the delivery of its services and rationalize its operations.

IV. The Economic Program for FY2005/06

36. Budget discipline and sound monetary policy will continue to be our focus in FY2005/06. We will also address structural issues, in particular public expenditure management, central bank operations, and tax reform. We will work on civil service wage and pension reform, clearing of domestic arrears, and privatization and commercialization of our state owned enterprises.

A. Fiscal Policy

37. Decisions on the budget for 2005/06 have been guided by the imperative of lowering our domestic debt burden. We have balanced our pressing social needs, the importance of clearing domestic arrears, and our strategy of investing in infrastructure for our future. We have also provided for food security by allocating funds for maize purchases and a revamped fertilizer program (Box 3). Our budget reflects domestic debt repayment of MK 1.8 billion.

Box 3. Fertilizer Scheme for FY2005/06

The government will again subsidize fertilizer for maize production in the 2005/06 agricultural season. Due to difficulties in implementing the previous TIPs program, we have decided to implement a different scheme. The government will subsidize two fertilizers used in maize production: Urea and NPK. This will target smallholders since they produce most of Malawi's maize. In addition, a labor intensive Public Works Programme (PWP) will economically empower the rural community to purchase maize and fertilizer. The program also includes a small amount for seed. A subsidy on fertilizer used for burley tobacco will also be introduced to ease the adjustment to sharply higher world fertilizer prices. Since most burley tobacco is grown by small holders, the subsidy is mostly self-targeting. The program will be monitored closely.

We will contract with the private sector to import and distribute 100,000 tons of maize fertilizer and 37,000 tons of burley fertilizer. The government will provide a subsidy for maize fertilizer of about MK 1900 per 50 kg bag, that will yield a target price to farmers of about MK1,000 per bag. For burley, the subsidy will average about MK 1200 per 50 kg bag, yielding a target price to farmers of about MK 1400 per bag. This arrangement will assist Malawi's farmers, many of whom suffered crop and income losses this year, and will cap the cost to government at MK4.8 billion, the larger part of which (MK 3.8 billion) will be used to subsidize maize fertilizer. At most two private firms will be used to avoid the problems in managing multiple contracts encountered in last year's TIP. The contract will be awarded based on a publicly-advertised competitive tenure process.

38. Our resource envelope is made up of tax and other revenues from Malawi and support from our development partners in the form of grants and low-interest loans. We have just concluded a general review of our taxes, but in view of our financial situation, any tax reforms must be revenue neutral, especially in the short run. Budget support from our development partners is estimated at about US$141 million. We anticipate that several key donors will make their disbursements early in our financial year as a means of making the availability of funds more predictable.

39. Spending on development projects consists of two parts, that financed by the government of Malawi and that provided through donor assistance. The total amount for investment in our future will be about 13 percent of GDP. We have consolidated investment programs from across ministries into the Public Sector Investment Program, which prioritizes projects according to the objectives in the MEGS and MPRSP. For 2005/06, we expect to shift some rural road maintenance and construction projects into the July-October period as a means of augmenting incomes of farming households who have suffered drought-related losses. This would enable them to purchase maize for the lean season and fertilizer for next year's crop.

40. Our recurrent spending budget will be very tight and we will seek efficiencies wherever possible. In general, ministries' budgets (excluding wages, maize purchases, and funding through the health SWAp) will be increased by less than 10 percent. We have also incorporated some rebalancing across ministries to provide more resources for pro poor spending and other priorities. In addition, the donor-financed health SWAp will add about MK 4.5 billion, and will leverage our health budget by providing medication, including for malaria and HIV/AIDS, equipment and hospital construction. It will also give a salary top up for health professionals who are in demand at home and in other countries.

41. The adverse weather conditions in February–March 2005 need to be addressed promptly (Box 4). Our objective is to ensure that food is available for all Malawians. We must, however, guarantee that the mistakes made in maize operations during 2001/02 are not repeated. These were very costly to the budget and hurt the next year's harvest by depressing local prices. Thus, we are focusing our efforts on humanitarian assistance and will distribute as much as 150,000 tons of maize to those in the greatest need. We will also purchase maize to act as a buffer stock that would be sold at tender to private distributors at the cost recovery price. This latter effort will help avoid shortages and price spikes that could develop because of the nearly two-month lead time needed to bring maize into Malawi from South Africa or ocean ports. Any unsold maize at the end of the season would be used to replenish the SGR.

42. Cost savings from the following measures have been included in the 2005/06 budget:

Government reorganization. The move of the President's residence to Lilongwe and the reduction in the number of ministries when the new government took office has produced savings in a number of areas including travel and office rents. Our current expenditure reporting system makes it difficult to estimate the savings in different categories precisely, but the gains have helped us limit increases in ORT in 2005/06. We are analyzing the impact of these measures to help guide us in the future.

- **Senior staff levels**. The reduction in the number of ministries in June 2004 has allowed us to cut the number of senior staff from over 500 to approximately 370 as of April 2005. We are now reviewing the structure of the remaining ministries and anticipate some consolidation of departments in the ministries that have been combined.

- **Construction**. We have tightened monitoring procedures for school and road construction and now require confirmation of completed projects before payments are made. This has already eliminated some fraudulent claims. We will strengthen these controls, through the implementation of the Procurement Act, the Public Audit Act and the Public Financial Management Act.

Box 4. Food Security in Malawi

Due to adverse weather conditions, the 2004/05 maize harvest is expected to be 25 percent less than in 2003/04. The crop is expected to reach 1.3 million metric tons, against a normal harvest of 1.8 million tons. However, estimates are tentative and there is the risk that the shortfall could be larger. In this event, donors have signaled their readiness to provide additional resources should the need arise.

The 2005/06 budget framework includes a package to provide adequate food security for all Malawians. The design of the package takes into consideration the need to ensure appropriate incentives for private sector imports this year and for production in the following crop season. The main elements of the package (whose costs are summarized in the table below) include:

Malawi: Government Food Security Transactions, FY05/06
Millions of kwacha

Total maize transactions	**-797**
Humanitarian	-1,175
EU/DFID grants	3,461
Purchase	-3,835
Distribution	-801
Commercial	378
Sale receipts	1,344
Purchase	-967
Maize stocks, '000 mt, eop	**0**
Carry over	47
Purchases	153
Distributions	200

Humanitarian: 150,000 tons of maize will be distributed through the Strategic Grain Reserve (SGR) to the most vulnerable without charge. This includes 27,000 tons in existing stocks. Two thirds of the purchase cost for the remaining 123,000 tons will be financed by grants from the EU and DFID and in kind by WFP. A further 70,000 tons may be funded by other donors. The cost of distribution will be borne by the government. These estimates do not include the costs of replenishing the SGR for 2006/07.

Commercial: 50,000 tons of maize will be distributed commercially. Existing stocks will be distributed and sold through Admarc at 17 kwacha per kg. We will also import 30,000 tons to be sold to commercial distributors at a cost recovery price.

Budget cost: The total fiscal cost of the government's food security transactions for FY05/06 is estimated to be 797 million kwacha.

- **Foreign missions**. We plan to close four of 17 foreign missions in early 2005/06. We estimate that this will save approximately MK 300 million per year, but these savings will be reallocated to other missions to make them more effective and reduce the chances of arrears accumulation.

43. Our overall budget savings strategy is to use the power of local decision making, accountability, and our new budget discipline to hold non priority costs to a minimum. The effectiveness of this approach was shown in 2004/05 when we virtually eliminated budget overruns. We are also pursuing a number of government-wide initiatives including:

- **Travel**. Past initiatives to reduce travel have not generated the expected results, in part because of weak enforcement of existing rules. We are reviewing our travel policy and its implementation with a goal of fairly reimbursing civil servants and eliminating over-reimbursements. As a start, we have put in place a travel policy for ministers that sets reimbursement levels, specifies authorization procedures, and clarifies reporting and record keeping requirements. We will have a new policy for all staff in place by end-March 2006 that emphasizes accountability.

- **Vehicles.** The Ministry of Finance will instruct all ministries to produce an inventory of their vehicles and include this, along with vehicle purchases and other changes to the inventory, in their monthly expenditure returns. We will undertake a study of our vehicle expenditures as a basis for introducing cost saving measures in the 2006/07 budget. We do not intend to impose a prohibition on vehicle purchases, because, for example, some of these may be required for health care delivery in rural areas.

- **Utilities**. We are aware that management of telephone, electric, and water use has deteriorated in recent years and will begin to introduce incentive mechanisms at the ministry level for savings in these areas. For example, new meters are being installed to make departments responsible for their electric use. Many of these are prepaid meters. We are considering a similar approach to control telephone use.

44. Our strategy for arrears will involve several steps that are outlined in the paper submitted to Cabinet for approval.

- **Identify all domestic arrears**. Under the direction of the Accountant General, we have developed a list of arrears as of end-June 2004, including MK 8.5 billion incurred by ministries and MK 2.2 billion stemming from court cases and other claims. This goes beyond the audit conducted in 2004 that covered only a sample of ministries and was hampered by data collection problems. Ministries will be expected to resolve any delayed payments since end-June 2004 through their own budgets.

- **Verify all claims.** A claim on government will be considered valid only if backed up by a contract signed by a government officer or invoice, and proof that the goods or services were provided.

- **Centralize arrears processing**. Ministries have sent claims, with supporting documents, to a technical team appointed by the Minister of Finance under the Accountant General.

- **Prioritization**. The special team will organize the certified claims according to a priority ranking established by the Cabinet. Special attention will be given to claims with penalty clauses, individuals (pension or salary arrears), and small firms.

- **Settlement.** The means of settling our domestic arrears will depend on the amount of certified arrears and any offsetting factors such as unpaid taxes. As the remaining arrears exceed the 2005/06 budget provision of MK 2 billion, we have developed a settlement plan consistent with available resources. Clearance of some of these arrears could involve payment in government securities and be phased over time.

- **New arrears**. Efforts are being made to avoid new arrears by improving financial management and adhering to the existing commitment control system. To the extent that arrears do emerge, for example through administrative delays, they will be cleared quickly using the spending ministry's resources. Our new program of monitoring each ministry's accounting departments on a regular basis should reduce the chances of unfunded commitments that can lead to arrears or payment delays.

Tax policy

45. We have completed a general review of our tax policies and tax administration which has benefited from the US Treasury and the Fiscal Affaires Department of the IMF. The main objective of the review is to ensure that we have the most appropriate tax policy for our country and that it provides a competitive environment that is conducive to private sector development. Any resulting changes to tax system, however, must be revenue neutral.

46. We will revise several tax rates during the 2005/06 financial year. For personal income taxes, we will raise the threshold of tax brackets in order to reduce the tax burden on very low paid workers and begin to reduce the top most tax rate in order to attract key professionals to Malawi. We will look at increasing fees in line with inflation and introduce changes to the VAT system to make Malawi more competitive.

47. The Malawi Revenue Authority (MRA) will be implementing the key findings of our tax review. We will be looking at the overall organization of the MRA, ways to improve staff training, and computerization of its operations. Our objective is to provide good service to our private sector, for example by refunding VAT claims promptly and enforcing tax regulations consistently. As an important first step, we have decided to

classify VAT refunds as statutory expenditures and eliminate the practice of granting VAT exemptions on government purchases.

Civil service wage and pension reforms

48. In October 2004, we introduced a new civil service pay policy that aimed to improve transparency, strengthen the incentive structure, and make pay policies consistent across government. This is a medium-term project that will be implemented in phases.

49. During 2005/06, we will begin to address problems that came up during implementation of this complex reform, while protecting some of the key achievements including:

- **Consolidation of wages and allowances**. Under the old system, some civil servants received a large part of their compensation in the form of allowances. These were untaxed, non transparent, and in some cases paid outside of the wage bill. The October 2004 reforms addressed these problems by putting all compensation into wages and salaries. It also unified the pay scale across government.

- **Incentives**. We have increased compensation of the middle grades of government officers to attract and hold the highest quality staff possible. Some further adjustments will be needed over the next few years as salaries are not yet on par with neighboring countries. These will need to be phased in as our financial situation permits.

- **Professionals.** We are currently reviewing salaries paid to medical and other professional staff. We may need to raise compensation in some of these areas and will base decisions on our ability to attract and retain those with specialized training.

50. The 2005/06 wage bill will be capped at MK 20 billion (domestically financed). To fit within this ceiling and also correct some of the anomalies introduced with the 2004 reform, a general salary adjustment will need to be small. However, civil service take home pay will benefit from the change in tax brackets mentioned above. The pay adjustment will be implemented in October 2005, one year after the wage reform went into effect.

51. We are also working on technical improvements to our pay system. During the year, we will be implementing a new computerized employment system that will help us better manage payroll records and match those being paid with authorized staffing levels. As part of this process we have already started a census of all civil servants. We will also review all salary adjustments at each grade level prior to implementation (see structural benchmark table).

52. Pension reform is an integral part of our overall civil service strategy and involves two steps. In the first, we revised the formula used to link an individual's pension benefits to his income because, under the existing contributory pension system, our new

consolidated pay structure would have resulted in an unfunded, ballooning in pension outlays. The revised formula bases pensions and gratuities on a five-year average of wages, rather than the individual's ending wage. We have also raised the normal retirement age to 60 years. For the second stage, we intent to move toward a funded, contributed system and will continue to investigate the costs and benefits of our options.

Supporting structural measures

53. During 2005/06 we will continue strengthening public expenditure management as a means of institutionalizing our success in expenditure control during 2004/05. Key measures to strengthen the current system include:

- **Supervision visits.** Our program of monthly visits to spending ministries has proved successful and will be continued. The visits have uncovered capacity limitations in accounting departments at the ministries and we will begin a new series of training sessions. In particular, we will provide guidance on bank and cash book reconciliation.

- **Monitoring government payments**. The new electronic CCA system at the RBM is providing new information on funding balances as well as providing a mechanism to end unapproved (unfunded) spending. We are pushing ahead with measures to make better use of this valuable data, in particular by reconciling holding account balances.

- **End-year closing**. Better end-year closing procedures will help us monitor budget execution by correctly placing expenditures in the correct budget year. We will restart the practice that would cut off contracts under the 2004/05 budget in early June to reduce the problem of check float into the next budget year. We will also require spending ministries to provide information on all checks written in [May and] June to the Accountant General so that these can be flagged in the government payment system and assigned to the correct budget year. We anticipate that these steps will improve our records and impose further controls on end-year spending. We will issue government circulars alerting all ministries to these requirements.

- **Account reconciliation**. We will also work with ministries to improve their account reconciliation so that data from the CCA system is more reliable.

- **Monthly funding**. During 2004/05 we implemented a new funding policy for ORT current spending. As a first step, we established three-month funding levels for each vote consistent with the approved annual budget and seasonal patterns. We then released monthly funding, but only to the extent that they would be covered by available resources, that is tax collections in the previous month less statutory expenditures. We will also continue to withhold funding when a ministry does not submit its expenditure return report for the previous month on time. These procedures were main factors behind the successful turnaround in our budget execution.

- **Financial control.** In the coming fiscal year, we will hold all financial controlling officers—typically principal secretaries—responsible for financial management in their ministries. We will do so through the Public Finance Management Act that includes provisions for disciplining controlling officers who spend or commit funds in excess of their approved budget limits.

54. As a means of moving ahead with medium-term expenditure management reforms, we have decided to adopt the public expenditure management system that has proved so successful in Tanzania. This will include their IFMIS system and a shift to a central payment system. We are thankful to the Government of Tanzania for the officers who have been placed at our disposal to help implement the system.

55. We have made significant progress with fiscal transparency and reporting. We submitted the 2003/04 government accounts to parliament in June 2005, somewhat behind schedule but earlier than in past years. We will continue to implement the reporting requirements as set out in the Public Financial Management Act and attaching priority to those aspects related to the responsibilities o f financial officers.

56. Improving our budget process will be a key part of restoring sound financial practices. For the 2005/06 budget, we refined our development plans based on the Public Sector Investment Plan and worked to integrate development projects spearheaded by our development partners. In the coming year, we will strengthen our medium-term planning, for example through the medium-term expenditure framework. We will also work to improve our ministry funding by explicitly identifying spending from special accounts such as the health SWAp.

57. Domestic petroleum prices were adjusted periodically during 2004/05 in response to world oil market developments, including a price increase in June 2005. As a result, the petroleum stabilization fund remained in surplus during most of 2004/05. In the period ahead, we will adjust pump prices using our established formula and rules. We are also looking into petroleum pricing on a regional level and may adopt best practices in our neighboring countries.

B. Monetary and Exchange Rate Policies

58. The objective of monetary policy during 2005/06 will be to reduce inflationary pressures. Inflation began to rise in 2004, reflecting the shortage of maize and the liquidity injection caused by high government borrowing in 2003/04. Liquidity management improved significantly in the second half of 2004, largely reflecting the containment of domestic borrowing by government. Our main instrument will be the purchase and sale of treasury bills. Sales of foreign exchange to mop up liquidity will be more limited than in

2004 because of our decision to withdraw from direct purchases of foreign exchange from smallholder tobacco farmers.

59. In the period ahead, the exchange value of the kwacha will be guided by market conditions, with some intervention to smooth pressures related to the tobacco season and inflows of donor assistance, but we will refrain from using administrative restrictions on the foreign exchange market over the program period. For our operating procedures during and after the tobacco marketing season, we will smooth fluctuations around the exchange rate offered by commercial banks.

Supporting structural measures

60. We are committed to improving banking supervision operations as a step toward enhancing financial intermediation. In the short term, this will require updating directives that govern the supply of critical information to the RBM. As a first step, we plan to complete an initial analysis of commercial bank balance sheets using asset classification consistent with international standards. In the medium-term, the RBM will aim to both increase resources to the department and implement a general restructuring.

61. We will aim to reduce our dependence on rule-based instruments for monetary policy. First, we remain committed to a lower liquidity reserve requirement (LRR) as this would reduce the operating costs of Malawi's commercial banks and make room for them to both reduce lending rates and increase deposit rates. Second, we will aim to reduce or eliminate the foreign currency surrender requirement. We will review these reforms in due course.

62. A precondition for the above-mentioned reforms is a well functioning money market, where monetary policy can be implemented using market-based instruments. Towards this goal, we will strengthen coordination between the Ministry of Finance and the RBM to improve liquidity forecasting. This will allow the RBM to announce accurately the amounts that will be offered in treasury bill auctions.

V. The PRSP Progress Report and HIPC Triggers

63. We will continue to implement the measures agreed at the time of the decision point to reach the HIPC completion point in 2006. The MRSP was finalized in 2002, with the assistance of our development partners. In September 2003 we finalized the first annual performance report (APR). Moreover, the second APR was completed and sent to the IMF and World Bank Executive Boards in June 2005. It evaluates past performance and presents our medium-term macroeconomic framework for the next three years and discusses policies to be implemented from 2005 onward. It also identifies areas in which the original PRS was weak. The policies included in the MEGS are basic to the implementation of the PRSP strategy by ensuring that growth takes place to attain poverty reduction.

64. We are aware that a successful implementation of the PRS will require strengthening our capacity to monitor poverty and evaluate the effect of the policies implemented. In this regard, we will be completing the analysis of the 2004/05 Integrated Household Survey in the second half of 2005 and formulate a new PRS in time for the 2006/07 budget. A comprehensive review of MPRS will also be completed.

VI. Technical Assistance and Data Issues

65. Malawi will need technical assistance to support program implementation in areas: public expenditure management, tax reform, monetary operations, and national accounts. The government will formally request assistance with financial management, monetary operations, the book entry system at the RBM, and measurement of the national accounts on a priority basis.

VII. Program Monitoring

66. The PRGF-supported program will be monitored quarterly, based on the quantitative and structural measures indicated in tables 1 and 2. These targets are defined in the attached Technical Memorandum of Understanding (TMU).

Table 1. Malawi: Quantitative Targets for FY2005/06 1/

	Criteria	Jun-05 Proj.	End-Sep. Target	End-Dec. Target	End-Mar. Target	End-Jun. Target
			(Cumulative Flows from June 30, 2005)			
I. Monetary Targets (In millions of Malawi kwacha)						
1. Floor on net foreign assets of the monetary authorities (In millions of U.S. dollars) 2/	PC	33.0	36.1	25.7	9.0	49.1
2. Ceiling on net domestic assets of the monetary authorities 2/	PC	15,520	-3,133	-1,839	-2,786	-2,608
3. Ceiling on reserve money	IT	19,580	1,314	1,324	-1,684	3,432
II. Fiscal Targets (In millions of Malawi kwacha)						
4. Ceiling on central government's net domestic borrowing 2/ 3/	PC	53,710	-783	-599	-2,398	-1,391
5. Ceiling on central government wages and salaries 3/	PC	...	4,848	9,934	15,218	20,730
6. Ceiling on central government discretionary expenditures 3/	IT	...	15,123	29,424	39,718	49,669
III. External Targets (In millions of U.S. dollars)						
7. Ceiling on the accumulation of external payments arrears 4/	PC	...	0.0	0.0	0.0	0.0
8. Ceiling on new nonconcessional external debt with a maturity over one year 4/	PC	...	0.0	0.0	0.0	0.0
9. Ceiling on new nonconcessional external debt with a maturity of less than one year 4/	PC	...	0.0	0.0	0.0	0.0

PC - performance criteria; IT - indicative target
1/ Targets are defined in the technical memorandum of understanding (TMU).
2/ Targets are subject to an adjuster for BOP support.
3/ Targets are subject to an adjuster for donor-funded health expenditures.
4/ Evaluated on a continuous basis.

Table 2. Malawi: Proposed Prior Actions, Structural Performance Criteria, and Benchmarks, July 2005-March 2006

Number	Description	Date
Prior Actions		
1	Parliament approval of 2005/06 budget in line with macroeconomic framework specified in the TMU (para. 28).	
2	Implement adjustment formula to the current pension system (TMU, para. 29).	
Performance Criteria		
1	Cabinet approval of arrears policy. Begin implementation (TMU, para. 30).	End-Sep. 2005
2	Compile new database of all public employees on the basis of DHRMD data forms (TMU, para. 31).	End-Sep. 2005
3	Make budget ceilings module in payment system fully operational (TMU, para. 32).	End-Dec. 2005
4	Develop and implement new travel policy, which includes mechanisms for monitoring adherence (TMU, para. 33).	End-Mar. 2006
Structural Benchmarks		
1	Develop detailed schedule of wage adjustments by grade for 2005/06.	End-Sep. 2005
2	Publish monthly fiscal reports with one month lag (TMU, para. 34).	End-Dec. 2005
3	Prepare quarterly reports (with one month lag) on status of arrears.	End-Dec. 2005
4	Strengthen cash management and expenditure monitoring procedures by preparing reports as indicated in the TMU (para. 35).	End-Mar. 2006
5	Complete impact analysis of tighter credit quality classifications on commercial bank balance sheets (TMU, para. 36).	End-Mar. 2006

Table 3: Malawi: Schedule of Disbursements During the First Year Program under the Proposed PRGF Arrangement
(In million of SDRs)

Amount	Date	Conditions Necessary for Disbursement
5.4190	Jul-05	Executive Board approval of three-year PRGF arrangement
4.9245	Feb-06	Completion of 1st review and observance of end-Sep. 2005 Performance Criteria
4.9245	May-06	Completion of 2st review and observance of end-Dec. 2005 PCs

Malawi—Technical Memorandum of Understanding

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

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

I. Quantitative Performance Criteria

A. Floor on Net Foreign Assets of the Monetary Authorities

3. **Definition of net foreign assets (NFA) of the monetary authorities:** NFA of the monetary authorities are defined as the difference between gross foreign assets and liabilities. NFA will be valued in U.S. dollars, and monetary gold will be valued at the fixed RBM accounting rate. The counterpart entry to the central government's international reserve assets will be classified as a negative entry under "net credit to central government".

4. **Gross foreign assets** of the monetary authorities are defined as the sum of the following: (1) monetary gold holdings of the RBM; (2) holdings of SDRs; (3) the reserve position in the IMF; (4) central government (treasury) holdings with crown agents; and, (5) holdings of convertible, liquid, and unpledged claims on non-residents, such as deposits abroad, and foreign securities. Excluded 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.

5. **Gross foreign liabilities** of the monetary authorities are defined as the sum of the following: (1) outstanding liabilities of the RBM to the IMF; and, (2) all short-term foreign currency liabilities of the RBM to non-residents with an original maturity of up to, and including, one year.

6. **Adjustment clause on net foreign assets—balance of payments support:** The floor on NFA of the monetary authorities will be adjusted upward (downward) by the full

amount by which the cumulative receipts from the balance of payments support are greater (less) than the program baseline (shown in table below). The downward adjustment will be capped at US$20 million and will only be effective if gross international reserves of the RBM are greater than US$200 million, with the following exception: In the second quarter of FY2005/06, the target will be adjusted downward up to US$25 million if the disbursement of the second tranche of the World Bank FIMAG is delayed.

7. **Definition of balance of payments support:** Balance of payments support includes all grants and foreign financing that is not linked to additional budgetary expenditure. Excluded from this definition is external project financing to fund particular activities, including food security funding from the European Union and usage of the Tokyo-Mitsubishi account, and loan financing from the IMF. Balance of payments support is measured as the cumulative flow from July 1, 2005.

Malawi: Balance of Payments Support, FY2005/06
(In millions of U.S. dollars)

	Q1	Q2	Q3	Q4	Total
Grants	60.2	20.0	36.1	0.0	116.3
EU	18.8	0.0	32.9	0.0	51.7
IDA	0.0	20.0	0.0	0.0	20.0
UK	38.2	0.0	0.0	0.0	38.2
Norway	3.2	0.0	3.2	0.0	6.4
IDA Loan	0.0	25.0	0.0	0.0	25.0
Total	**60.2**	**45.0**	**36.1**	**0.0**	**141.3**
Cumulative total	**60.2**	**105.2**	**141.3**	**141.3**	

Sources: UK, EU, Norway, AfDB, and WB.

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

8. **Definition of net domestic assets (NDA) of the RBM:** NDA of the RBM is defined as reserve money minus net foreign assets valued at the program exchange rate of MK 123 per US$1. Reserve money consists of currency issued by the RBM and balances of commercial banks accounts with the RBM. It includes required reserves held for Malawi kwacha deposits and any other domestic currency reservable liabilities and other demand and time deposits held with the RBM.

9. **Adjustment clause on net domestic assets—balance of payments support:** The ceiling on net domestic assets of the RBM will be adjusted downward (upward) by the full amount by which the cumulative flow of receipts from balance of payments support is

greater (less) than the program baseline. The upward adjustment will be capped at US$20 million and will only be effective if gross international reserves of the RBM are greater than US$200 million, with the following exception: In the second quarter of FY2005/06, the target will be adjusted upward up to US$25 million if the disbursement of the second tranche of the World Bank FIMAG is delayed. Balance of payments support will be converted to Malawi kwacha using the program exchange rate (see para. 7 for the definition of balance of payments support).

10. **Adjustment clause on net domestic assets—liquidity reserve requirement:** The ceiling on net domestic assets of the RBM 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. The adjuster will be calculated as follows: (one minus the percentage of reserve assets held at the discount houses) multiplied by (the program baseline required reserve ratio minus the new required reserve ratio) multiplied by (the amount of reservable deposit liabilities in commercial banks as at the end of the quarter prior to the change in regulation).

C. Ceiling on Central Government's Domestic Borrowing

11. **Definition of central government's domestic borrowing (CGDB):** CGDB is computed as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, 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), (iii) net borrowing from nonbanks (including holding of local registered stocks, holdings of treasury bills, and supplier credits minus government deposits held at the Malawi Savings Bank), and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost. Excluded are promissory notes issued to cover RBM's operational losses in 2002 and 2003. The ceiling is measured as the cumulative flow from July 1, 2005.

12. **Definition of June 2004 domestic arrears:** June 2005 domestic arrears consist of all domestic arrears for which the obligation to pay was established on or before June 30, 2004.

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

14. **Adjustment clause on CGDB—balance of payments support:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the cumulative receipts from balance of payments support is greater (less) than the program baseline (see para. 7 for the definition of balance of payments support). The upward adjustment will be capped at US$20 million and will only be effective if gross international reserves of the RBM are greater than US$200 million, with the following exception: In the second quarter of FY2005/06, the target will be adjusted upward up to US$25 million if the disbursement of the second tranche of the World Bank FIMAG is delayed.

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

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

17. **Adjustment clause on CGDB—maize revenue:** The ceiling on CGDB will be adjusted upward (downward) by the full amount by which the cumulative receipts from the sale of commercial maize through ADMARC and deposited in the RBM maize account is less (greater) than the program baseline (shown in table below).

18. **Adjustment clause on CGDB—donor pool account for the health SWAp:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the change (in Kwacha) of the stock in the US dollar denominated donor pool account for the health SWAp at the RBM is larger (smaller) than the change (in Kwacha) of the stock in that account in the program baseline (shown in table below). The change in stock is measured relative to the stock as of June 30, 2005. Stocks in the account are stated with a positive sign.

19. **Adjustment clause on CGDB—National Aids Commission (NAC) accounts:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the change (in Kwacha) of the stock in the accounts of the NAC held in the Malawi banking system is larger (smaller) than the change (in Kwacha) of the stock in those accounts in the program baseline (shown in table below). The stock of the NAC accounts will be determined on the basis of the quarterly financial reports of the NAC. The change in stock is measured relative to the stock as of June 30, 2005. Stocks in the accounts are stated with a positive sign.

Malawi: Maize revenue, Health SWAp, and NAC Funds, FY2005/06
(In millions of Malawi Kwacha)

	Q1	Q2	Q3	Q4	Total
Maize revenue					
Quarterly receipts	170	334	840	0	1,344
Cumulative receipts	170	504	1,344	1,344	
Health SWAp					
Revenues	754	1,840	947	1,925	5,466
Wage expenditures	177	181	184	188	730
ORT Expenditures	1,016	1,046	1,063	1,075	4,200
Change in account balance	-439	613	-299	661	536
Cumulative wage expenditures	177	358	542	730	
Cumulative ORT expenditures	1,016	2,062	3,125	4,200	
Cumulative change in account balance	-439	174	-125	536	
National AIDS Commission (NAC)					
Revenues	1,269	1,309	1,340	1,364	5,282
Expenditures	1,269	1,309	1,340	1,364	5,282
Change in account balance	0	0	0	0	0
Cumulative change in account balance	0	0	0	0	

D. Ceiling on Central Government Wages and Salaries

20. **Definition of central government wages and salaries:** Central government wages and salaries include all payments that are classified as personnel emoluments in government budgets and accounts, including payments on arrears of personnel emoluments and allowances. The ceiling is measured as a cumulative flow from July 1, 2005.

21. **Adjustment clause on central government wages and salaries—donor-funded wages and salaries in the health sector:** The ceiling on central government wages and salaries will be adjusted upward (downward) by the full amount of donor-funded supplementary wages and salaries for the health sector that is greater (less) than the program baseline (see table above).

E. Ceiling on External Payment Arrears

22. **Definition of external payment arrears:** External payment 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, except on external debt subject to rescheduling or restructuring. A continuous performance criterion applies on the nonaccumulation of external payment arrears on external debt contracted or

guaranteed by the central government, the RBM, or other agencies on behalf of the central government or the RBM.

F. Ceiling on Nonconcessional External Debt

23. **Definition of nonconcessional external debt:** The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decisions No. 11096-(95/100), October 25, 1995; and 12274-(00/85) August 24, 2000. For program purposes, a medium- and long-term debt is nonconcessional if it includes a grant element less than 35 percent. The ceiling on nonconcessional debt applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf of the central government or the RBM on debt with nonresidents. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from July 1, 2005.

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

II. Quantitative Indicative Targets

A. Ceiling on Reserve Money

25. **Definition of reserve money:** Reserve money is defined as the sum of currency issued by the RBM and balances of commercial bank accounts with the RBM. It includes required reserves held for Kwacha deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM.

B. Ceiling on Central Government Discretionary Expenditures

26. **Definition of central government discretionary expenditures:** These are defined as all expenditures excluding (i) wages and salaries, (ii) interest payments, and (iii) foreign-financed development expenditures (development Part I expenditures) which are related to specific projects. Central government discretionary expenditures include statutory (i.e., nonvoted) expenditures for pensions and gratuities, and compensation and refunds; but exclude tax refunds (which are treated as a negative revenue). Central government discretionary expenditures also include other recurrent expenditures (ORT), domestically financed development expenditures (development Part II expenditures), and net lending (if

any). Included in this definition are also recurrent expenditures and development Part II expenditures for which cash financing is or was made available by donors. Included in particular are all maize purchases for the Strategic Grain Reserve, purchases financed from the Japan debt relief account (see paragraph 19), and expenditures in the health sector financed from the donor pool account in the RBM for the health SWAp. The ceiling is measured as a cumulative flow from July 1, 2005.

27. **Adjustment clause on central government discretionary expenditures—donor-funded central government discretionary expenditures in the health sector.** The ceiling on central government discretionary expenditures will be adjusted upward (downward) by the full amount of donor-funded **central government discretionary** health sector expenditures that is greater (less) than the program baseline (see table above). In respect of resources made available through the U.S. dollar denominated donor pool account for the health SWAp at the RBM (donor pool account), donor-funded central government discretionary expenditures in the health sector will be deemed to have been made according to the calculation: 'outflows from the donor pool account to finance expenditures, expressed in Malawi Kwacha' less 'donor financed supplementary wages in the health sector'.

III. Structural Prior Actions, Performance Criteria, and Benchmarks

28. **Approval of FY2005/06 Budget:** The FY2005/06 budget passed by parliament should be in line with the program baseline, with other recurrent and domestic development expenditures of no more than MK 49.6 billion, a wage bill (including health SWAp) of no more than MK 20.7 billion, and tax policies in line with program assumptions.

29. **Formula Adjustment to pension formula:** Adjustments to the formula used to calculate an individual's benefit should allow for a total cost of pensions lower than MK 3.5 billion in 2005/06.

30. **Domestic Arrears Strategy:** The government will identify, verify, and clear June 2004 domestic arrears in accordance with the guidelines set forth in the MEFP (para. 45). Begin implementation is defined as identifying all arrears, in addition to starting the process of verification. Ministries are expected to resolve any domestic arrears incurred since June 30, 2004 through their annual budget allocations.

31. **Employee database:** The database will be based on the DHRMD data forms collected for the FY2005/06 government payroll, and should include information on all employees by ministry, grade, and salary.

32. **Budget ceiling module:** For the purposes of expenditure management, the budget module of the payments system at the RBM should be made fully operational. This requires that the following three steps are completed: (1) All bank accounts are reconciled between the RBM and commercial banks; (2) All data are reconciled between the RBM holding

accounts and the fiscal data according to the Ministry of Finance ledgers; and (3) the Accountant General's office provides the RBM with a list of check numbers for outstanding checks issued against the 2004/05 budget. These checks should be entered into the payment system in order to identify the float from the 2004/05 budget into fiscal year 2005/06 for the CCA system. Finally, the RBM should produce tables by CCA category listing funded amounts against total reimbursement for the current fiscal year. In the future, the Accountant General should develop a concordance between budget votes, cost centers, and RBM holding accounts into which CCAs are credited, and produce tables by budget vote.

33. **Travel Policy:** The Ministry of Finance will develop a travel policy that will be ready for the FY2006/07 budget and will aim to reduce and account for all expenditure on travel.

34. **Publication of Fiscal Reports:** The Ministry of Finance will publish the following documents on a monthly basis: the GFS fiscal table, the arrears clearance report, and the report on pro-poor expenditures.

35. **Impact Analysis:** Collect information on credits overdue 30 days or more but less than 180 days. Based on this information, an analysis should be completed of tightening credit quality classification to 90 days for substandard, 180 days for doubtful, and one year for loss.

36. **Strengthening cash management:** Prepare and implement the following two reports: (1) a budget execution report based on a new monthly table by ministry and expenditure type (PE, ORT, and development, including below the line accounts like advances and imprests) that shows (i) approved budget per vote/ministry, (ii) funding released to ministries per funding table, (iii) commitments made as reported by ministries on commitment control system reports (iv) expenditures as reported by ministries on expenditure returns, and (v) payments made according to CCA system; and (2) an amended funding table that indicates the allocation of funding based on three sources: the MG1 account, automatic payment by standing instruction (e.g., regular foreign payments or withholding), and foreign financing sources.

IV. Treatment in the Fiscal Accounts and Balance of Payments of Certain Central Government (CG) Accounts Held Abroad

37. **The account held with the Bank of Tokyo-Mitsubishi in Japan:** The account was set up for the delivery and administration of Japanese debt relief. Disbursements of cash debt relief into the account are accounted as grants with corresponding amounts of foreign financing (increases in the deposit account). Withdrawals from the Bank of Tokyo-Mitsubishi account are accounted as central government expenditures with corresponding amounts of foreign financing (decreases in the deposit account). Expenditures financed from this account are included in spending agencies budgets under current expenditures, or

as development Part II expenditures (development expenditures financed by the Government of Malawi). Flows are valued at the end-month exchange rate.

38. **The European Union grants for food security purposes and the food reserve account**. These grants are given to provide a cash reserve to the Government of Malawi for the purchase of food stuff (in particular maize) at times of food shortages. Access to foreign or domestic accounts that have been or are being established to administer these resources is determined by agreements between the European Union and the Government of Malawi. Deposits into the account held abroad are recorded as grants with corresponding amounts of foreign financing (increase in deposit accounts). Withdrawals from the account held abroad are recorded as increase in foreign financing. If and when the resources are transferred to Malawi, they are to be held in a bank account in the banking system until needed, and are counted as part of net credit to government. Withdrawals from the foreign or domestic accounts for payments to suppliers are recorded as an appropriate expenditure item (e.g., purchase of food stuffs), and a decrease in the respective deposit account. Should the food reserve account be operated like a revolving fund, all cash inflows are accounted as appropriately classified revenue, and an increase in the deposit account. The balance in the foreign and domestic food reserve accounts is reported separately in the monetary data.

V. Reporting of certain transactions in the Fiscal Accounts

39. **Operations of the National Aids Commission (NAC)**. Financial operations of the NAC are included in the fiscal accounts according the NAC's financial reports. Expenditures are typically classified as development Part I expenditures. Government ministries and departments that execute projects financed by NAC report these activities to NAC for inclusion in the NAC's financial reports.

40. **Donor pool funded expenditures in support of the Health SWAp**. The Government of Malawi has embarked on the implementation of an integrated program of service delivery in the health sector, the health sector wide approach (Health SWAp). In support of the Health SWAp some donors are pooling resources (the donor pool), and release these resources through normal government procedures (i.e. recurrent budget or development Part II budget) to the health sector. In order to manage the inflows of donor resources a U.S. dollar-denominated account has been set up at the RBM that holds donor pool resources until expenditures need to be financed. Donor funded expenditures for the Health SWAp from the pooled resources will be deemed to have been made in the amount of outflows from the donor pool account to finance expenditures (i.e., typically either to Malawi government No. 1 account in Malawi Kwacha, or to pay directly for imports by the health sector). The attribution of donor financed expenditures to personnel emoluments, other recurrent transactions, and development Part II expenditures is made on the basis of cash flow projections and established donor commitments to finance specific expenditures (e.g., supplementary wages and salaries for professional health cadres). Typically,

expenditures for other recurrent transaction are estimated as the residual of outflows less expenditures for wages and salaries less expenditures for development Part II.

Malawi: Reporting Requirements

Data description	Data Freq.	Reporting Agency	Reporting Freq.	Delivery Lag	Delivery Date	Delivery Mode
Gross international reserves, exchange rate, and foreign exchange purchases and sales	D	RBM	W	2	F	E
Reserve money, OMO transactions, and RBM conversion of treasury bills	D	RBM	W	2	F	E
Treasury bill and RBM bill auction results	W	RBM	W	2	F	E
RBM balance sheet and broad money estimate	W	RBM	W	7	F	E
Four-bank monetary survey	M	RBM	M	30	30	E
Central government domestic borrowing	M	RBM	M	30	30	E
Interest rates	M	RBM	M	30	30	E
Holdings of local registered stocks, treasury bills, and RBM bills	M	RBM	M	30	30	E
Issue and maturity profile for treasury bills and RBM bills	M	RBM	M	30	30	E
Excess reserves by bank	D	RBM	M	30	30	E
Details of project and balance of payment support	M	RBM	M	30	30	E
Monthly exchange rates	M	RBM	M	30	30	E
FCDA holdings	M	RBM	M	30	30	E
Cash flow of foreign exchange	M	RBM	M	30	30	E
Foreign exchange exposure limits by bank	M	RBM	M	30	30	E
Bank statements of both the Health SWAp and government maize account held at the RBM	M	RBM	M	30	30	E
Seven bank monetary survey and full banking survey	M	RBM	M	45	15	E
Financial soundness indicators by banks	Q	RBM	Q	45	T15	E
Insurance company survey	Q	RBM	Q	45	T15	E
Fiscal table (GFS) including revenue, expenditure, and financing.	M	MOF	M	30	30	E
Funding tables on wages, other recurrent expenditures, and development	M	MOF	M	30	30	E
CCA, supplementary CCA, and reimbursement report	M	MOF	M	30	30	E
Pro-poor spending	M	MOF	M	30	30	E
Tokyo-Mitsubishi account statements	M	MOF	M	30	30	E
Revenue data (from MRA)	M	MOF	M	30	30	E
PSI import data	M	MOF	M	30	30	E
Ministry reports on commitment and expenditures (CCS3 and CCS4 returns)	M	MOF	Q	30	T30	E
New external loans contracted or guaranteed by the central government 1/	Q	MOF	Q	30	T30	E
List of nonreschedulable external arrears by creditor 2/	Q	MOF	Q	30	T30	E
Budget execution report, including arrears and prospects for meeting budget targets based on the CCS3 and CCS4	M	MOF	Q	45	T15	E
Borrowing of the ten major parastatals 3/	Q	MOF	Q	45	T15	E
Quarterly financial statements of the ten major parastatals and MSB	Q	MOF	Q	45	T15	H
Report on PRGF performance	Q	MOF	Q	45	T15	E
Report on verified pre 30. June 2004 expenditure arrears	Q	AuG	Q	45	T15	E
Report on new post 30. June 2004 arrears verified by AuG	Q	AuG	Q	45	T15	E
Annual audited financial statements of the ten major parastatals and MSB	A	MOF	A	90	Mar. 30	H
Consumer price index and monthly statistical bulletin	M	NSO	M	30	30	E
Import and export data	M	NSO	M	45	T15	E
Balance of payments, and quarterly statistical bulletin	Q	NSO	Q	45	T15	E
National accounts, balance of payments, and quarterly statistical bulletin	A	NSO	BA	45	Mar. 15; Sep. 15	E

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

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

2/ To be reported by DAMD, including a detailed explanation.

3/ Agriculture Development and Marketing Corporation, Air Malawi, Electric Supply Company of Malawi, Malawi Development Corporation, Malawi Housing Corporation, Malawi Postal Corporation, Malawi Telecommunications Ltd., Northern Regional Water Board, Central Regional Water Board, and Southern Region Water Board.

Malawi: Relations with the Fund
(As of May 31, 2005)

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

II. **General Resources Account**:

	SDR million	Percent Quota
Quota	69.40	100.00
Fund holdings of currency	84.46	121.70
Reserve position in Fund	2.29	3.30

III. **SDR Department**:

	SDR million	Percent Allocation
Net cumulative allocation	10.98	100.00
Holdings	0.34	3.08

IV. **Outstanding Purchases and Loans**:

	SDR million	Percent Quota
Poverty Reduction and Growth Facility (PRGF) arrangements	39.91	57.50
Emergency Assistance	17.35	25.00

V. **Financial Arrangements**:

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

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

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	10.07	17.86	13.41	5.37	4.10
Charges/Interest	0.65	0.88	0.52	0.34	0.31
Total	10.72	18.74	13.93	5.71	4.41

VII. **Implementation of HIPC Initiative:**

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

VIII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Reserve Bank of Malawi (RBM) is subject to a safeguards assessment with respect to the requested Poverty Reduction and Growth Facility. An off-site assessment was conducted in July 2001, followed by an update assessment, completed in July 2003. The latter concluded that the RBM had made progress in remedying vulnerabilities, and it proposed steps to further strengthen the RBM's operations and safeguards, particularly in the areas of external audits, financial reporting, and internal controls. A new full safeguards assessment of the RBM has been initiated and is expected to be completed before the first program review.

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

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

IX. **Exchange Arrangements**:

The exchange rate of the Malawi kwacha is managed float. On May 31, 2005, the exchange rate was MK 119.5 = US$1.00.

X. **Article IV Consultation**:

Malawi is on the standard 12-month Article IV consultation cycle. The last Article IV consultation (Country Report No. 04/380) was concluded by the Executive Board on October 18, 2004.

XI. **Technical Assistance**:

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

XII. **Resident Representative**:

Mr. Thomas Baunsgaard since August 16, 2004.

Malawi: IMF-World Bank Relations

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

A. World Bank Country Assistance Strategy (CAS)

1. The Malawi CAS was approved by the Bank's board on May 14, 2003. The gray cover report (Report # 25906 MAI) outlined the current social, economic, and political situation in Malawi and proposed strategies for the next three years (FY04-06), based on the lessons learned from the previous strategies. This strategy presents a transitional program that aims to help the Government to address urgent development issues. Preparation for a new CAS has begun and will be completed in the coming Fiscal Year.

2. The current CAS program is organized under three pillars: i) strengthening economic management, ii) establishing a platform for growth; and iii) improving service delivery and strengthening the safety net. Three ongoing projects (Financial Management Transparency and Accountability; Privatization and Utility Reform; and Global Development and Learning Network), and a Structural Adjustment Credit (Fiscal Management and Accelerating Growth Project) will assist in attaining the objectives under pillar one. To support the objectives of pillar two, the on-going Community Based Land Reform and Road Maintenance and Rehabilitation Projects, as well as two pipeline projects (Infrastructure Services Project and Agriculture Project) are under the base case. The World Bank also supports Malawi's participation in Southern Africa Power Market Project, which contributes to the achievement of pillar two. Core Bank interventions under pillar three include the HIV/AIDS (MAP) Project, Third Malawi Social Action Fund Project; Secondary Education Project, and two new Projects, First Education Sector Support Project, and Health Sector Program with a sector-wide approach (the first in Malawi). Emergency Drought Recovery Project, which aimed to contribute to pillar three, recently closed with successful results. Finally, Malawi also benefits from the Bank funded Regional Trade Facilitation Project, which contributes to poverty alleviation through private sector led growth by improving access to financing for productive transactions and cross-border trade.

B. Financial Relations with the World Bank Group

3. The World Bank has been active in Malawi since 1966. Total lending to Malawi from the World Bank as of May 2005 is US$2,437 million, of which US$2,146 million has been disbursed. Currently there are thirteen active projects in Malawi with a net commitment of US$376 million, and an undisbursed balance of US$234 million. Sectoral breakdown is as follows: Rural at 9%, Transport at 8%, Public and Private Sector Development and Finance at 32%, and Social Sectors at 51%.

4. IFC has two investments in Malawi, with 44% in capital markets and the balance in tourism, totaling a meager US$1.16 (US$0.64 million in loans and US$0.52 million in

equity). Future focus will be on expanded IFC assistance for the private sector, especially in areas of manufacturing, mining and tourism that Malawi has indicated as its target areas to reduce its dependence on agriculture.

C. Areas in Which the Bank Leads

Education and Health

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

6. The Health Sector Support Project for Malawi (the first project with a Sector Wide Approach in Malawi) aims to improve the effectiveness, efficiency and equity of the essential health care delivery system in Malawi. The project (with US$15 million in grants) was approved in December 2004, and has the following three components: Component 1) will improve the health status of the Malawian population by increasing access to quality essential health services. The main mechanism for delivering quality care would be by making the already-defined Essential Health Package (EHP) accessible to all, but especially in the most rural and disadvantaged districts and to the poorest and vulnerable populations. Component 2) will increase the number of staff available through continuation of the six-year emergency training plan, a concerted recruitment campaign, financing and then filling current vacancies, the use of volunteers and contract staff and other stop-gap staffing strategies. Component 3) will improve the effectiveness and efficiency of both the health system and the referral network to support delivery o f the EHP.

7. The First Education Sector Support Project for Malawi (with US$32.2 million in grants) was approved in May 2005, and will provide immediate financing to support the education sector in Malawi. The project has the following six components: Component 1) will complement government and donors' efforts to improve quality and expand capacity of teacher development and training at all levels. Component 2) will improve the conditions of learning at selected secondary schools staffed with trained teachers or newly trained teachers. Component 3) will provide a School Health and Nutrition package to all primary schools, which will include: distribution of vitamin A and iron-folic acid to school children under 10 years old, de-worming, treatment of malaria and fever, and the promotion of good health and nutrition practices. Component 4) will supply basic learning materials directly to schools while strengthening the participation of communities in school management. 5) Capacity Building and Policy Development will cover: (i) national education policy consolidation and capacity building; and (ii) support to implementation of government

decentralization policy in education. Component 6) will support the physical implementation and management of fiduciary and procurement issues.

8. The Secondary Education Project (US$48.2 million), slated to close in December 2005, aims to increase the number of students from disadvantaged groups who graduate from public and private secondary schools, with higher performance. There are five components in this project: expanding access to secondary education; provision of instructional materials in the project-financed schools and textbooks, school supplies, and consumables for sciences for the other schools; provision of training for school-based managers; financing HIV/AIDS materials; and support to administrative unit/monitoring & evaluation/studies.

Social Protection and Community Development

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

Infrastructure

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

Privatization

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

enterprises, such as the postal service. The Project is presently being restructured to: address slow implementation progress, respond to new challenges facing the Government, incorporate lessons learned and improve the effectiveness of the program.

Agriculture

12. A Community based Rural Land Development Project (US$27 million) was approved by the Board in April 2004. Based on positive community-level experience gained in the MASAF projects, and in partnership with the Government and UK's Development agency, DFID, this project will involve the acquisition of idle land and their transfer to small farmers, thus enabling them to be self-sufficient in food and, hopefully, grow surpluses for commercial sale. It is urgent that Malawi move toward a more equitable distribution of land that will provide food security for small-holders. The Structural Adjustment Credit, FIMAG, also supports agricultural policy reforms (see further details in paragraph 20 below).

13. An Irrigation, Rural Livelihoods and Agriculture project is under preparation at present (for FY06), to complement other activities on the ground. The overarching development objective of the proposed project is to raise agricultural productivity and net incomes of poor rural households in target districts of Malawi in a sustainable manner by providing an integrated package of support covering irrigation, agricultural/ irrigation advisory services, marketing and post-harvest assets and services, and capacity building.

Environment

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

Knowledge Sharing

15. A Global Distance Learning Network Project (US$4 million) was approved in March 2004. Working in conjunction with the Malawi Institute of Management, the Bank Group plans to finance the creation of a Development Learning Center (DLC) that will provide training in key fields to Malawian civil servants, including, for example, technical, policy development, and management

Poverty Monitoring

16. The Bank is supporting the National Statistical Office with one aspect of the poverty monitoring tasks identified in the PRSP as requiring technical assistance. Through the

PRSP Trust Fund, the Bank is assisting the government in conducting the Second Integrated Household Survey, including design, collection, processing, and dissemination of data covering not only household characteristics, but also community level indicators. A Poverty Assessment is planned for FY06, and will provide an in-depth analysis of the new household data.

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

Poverty Reduction Strategy

17. The Government of Malawi finalized its Poverty Reduction Strategy Paper (PRSP) in April 2002. A joint IDA-IMF staff assessment was presented to the Boards of IMF and the Bank on July 19, 2002 and the strategy was endorsed by the Boards of the IMF and the World Bank in August 2002. The IMF and the Bank staff maintained collaborative relationship in supporting the government in the process. The first Annual Progress Report (APR) was approved by the Boards in October 2003 and indicates that MPRSP implementation was limited. The second APR and Joint Staff Assessment Note (JSAN) for the period July 2003-June 2004, which will be submitted to the Boards in mid-2005, also indicates that MPRSP implementation has been limited. The third APR (looking at the period July 2004-June 2005) is expected in the late 2005.

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

18. Staff of the IMF and the Bank prepared "Malawi: Decision Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative" which was presented to the Board on December 8, 2000. The total amount of debt relief assistance to Malawi is equivalent to around $1.0 billion in nominal terms (US$643 million in NPV terms). Debt relief will be delivered between January 2001 and December 2020 by providing 55 percent relief on annual debt service due. IDA is the largest creditor to Malawi, accounting for 51 percent of the entire external debt (and 69 percent of multilateral debt).

19. The update of the HIPC Activity Action Plan (AAP) report for Malawi was recently jointly completed.

Budgetary Planning, Revenues Administration, and Public Expenditure Reforms

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

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

Civil Service and Wage Reform

22. Following the World Bank's financed study on review of civil service and wage policy issues, the Government has begun implementation of the recommendations of the study at the end of 2004. These include: streamlining the system of allowances; consolidating them in the base for personal income tax; rationalizing salary grades; and moving towards a unified salary structure. These reforms are also supported under the IMF Staff Monitored Program.

Humanitarian Assistance

23. The Emergency Drought Recovery Credit (EDRC, US$50 million, of which US$21 million is in the form of an IDA grant) approved in FY03, closed in November 2004 after a successful run. The Project's objectives were: a) to allow government to maintain key commitments to economic priorities and investments; b) to help restore the productive capability of the populations; and, c) to support longer term disaster management by the government. The Board of the IMF also approved Emergency Assistance (US$23 million) to Malawi in September 2002, to provide balance of payments support in the face of a severe drought.

E. Areas in Which the Fund Leads

Macroeconomic Stability, Fiscal Policy, and Monetary Policy

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

MALAWI: STATISTICAL ISSUES

1. Malawi's economic statistics show serious deficiencies, which have affected program monitoring. A Report on the Observance of Standards and Codes, February 2005, found that, while the legal and institutional framework for the production of macroeconomic statistics was broadly adequate, there are shortcomings in the scope, accuracy, and reliability of data. There is a need for strengthening the provisions of the Statistic Act to define the responsibility of the Ministry of Finance for the compilation of government finance statistics and of the Reserve Bank of Malawi in the compilation of monetary statistics. The authorities are making efforts to improve the quality and timeliness of the statistical data. Malawi is a participant in the GDDS since December 2002 and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). Malawi receives technical assistance under the project for Anglophone African countries sponsored by DFID.

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. Additional resources are needed by the National Statistics Office (NSO) to meet, in particular, the required quality standard of national accounts.

National accounts

3. The NSO has the responsibility for compiling the national accounts data. However, while the final estimates are comprehensive,[1] the source data underpinning these estimates are inadequate, owing to gaps, especially for medium- and small-scale establishments, and informal activities that affect the coverage of the national accounts. The statistical techniques used for national accounts compilation are deficient, and processes to assess and validate source, intermediate and final data are generally limited. The national accounts are published in the *Statistical Yearbook* and *Quarterly Statistical Bulletin* with a significant time lag.

Prices

4. A consumer price index (CPI) is available on a timely basis. The CPI index is based on the 1997/98 household survey results, and data are collected on a monthly basis by regional price collectors. The effectiveness of the index could be improved by applying

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

systematic, comprehensive, and consistent approaches to the quality adjustment of product prices.

Trade

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

B. Government Finance

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

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

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

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

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

- Data on **expenditure arrears** are likely incomplete, as reporting from the Commitment Control System appears to be only partial, and ministry level data are not consistent from report to report. Previously unknown arrears have repeatedly been cleared through the "special activities" vote, thus calling into question the accuracy of arrears data as well as these data on clearances.

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

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

7. The authorities have received significant technical assistance from the Fund and other donors to strengthen expenditure monitoring and reporting, accounting, and statistical reporting, but results have not been adequate. The new government has pledged to strengthen public financial management and fiscal reporting, and renewed efforts are being made to establish a work plan, including effectively utilizing donor technical assistance.

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

C. Monetary Accounts

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

10. Concurrently, the mission completed the development of an integrated database that will be used by the RBM, STA, and AFR for publication and operational needs. The mission also discussed the standardized forms (SRF) that will be adopted in the near future by all countries for reporting monetary data to STA. The RBM is examining the SRF with a view to reporting monetary data to the IMF using the SRF as soon as feasible.

D. Balance of Payments

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

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

Malawi: Common Indicators Required for Surveillance
(As of June 30, 2005)

	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	06/05	06/05	06/05	06/05	05/05	06/05	05/05	11/04	11/04	05/05	2002	12/03
Date received	06/05	06/05	06/05	06/05	06/05	06/05	06/05	04/05	04/05	06/05	03/04	07/04
Frequency of data[1]	D	D	D	W	M	W	M	M	A	M	A	M
Frequency of reporting data[1]	W	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	M	M	M	C	C	C	C	Mission
Confidentiality[4]	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of publication[1]	M	M	M	Q	M	W	M	A	A	A	A	…

[1] D = daily; W = weekly; 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: External Debt Sustainability Analysis

This appendix presents a debt sustainability analysis of Malawi's external debt over the medium term.[1] This analysis (DSA) is based on the framework for external debt sustainability in low income countries (www.imf.org)[2] and further considerations papers (www.imf.org). The implications of the recent proposal from the G8 for debt cancellation and the recently approved IDA14 replenishment, which will increase the grant component, have not been incorporated into the analysis.

The macroeconomic framework corresponds to the authorities medium-term program to be supported by the proposed PRGF arrangement. It incorporates information provided by donors and recent pledges to finance the food gap associated with the recent dry spell. This framework is based on a mixed of grants and loans that are heavily dependent on grants, reducing Malawi's borrowing with respect to previous projections. Assuming that the envisaged grants are provided, Malawi could be considered to be in a less risky position than in previous projections.

The stock of external debt at end-2004 was estimated at about US$3 billion in nominal terms, equivalent to 159 percent of GDP. New borrowing during 2000-04 remained in line with the anticipated new borrowing at the time of the HIPC decision point (based on end-1999 data). Malawi's largest creditors continue to be multilateral institutions. Japan is the largest bilateral creditor.

Besides the macroeconomic assumptions detailed in the staff report, the following additional assumptions regarding the external sector have been used in the DSA:

- Export volumes are expected to grow at a rate of about 4 percent over 2006-10 and 4.8 percent from then onward. Tobacco will continue to be the main export product (about 50 percent of total exports at end-2004), but will slowly fall to 40 percent by 2022. The authorities' plans to improve roads and railway connections are expected to significantly improve non-traditional exports. Import volumes are projected to grow at a rate of about 4.5 percent per year.

- Foreign direct investment is envisaged to average US$35 million during 2005-14 and increase to about US$60 million in the subsequent years.

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[1] Results of the DSA are preliminary. A detailed HIPC DSA based on a loan by loan reconciled information will be conducted in the context of the completion point.

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

- Official grants are expected to remain at about 10 percent of GDP during 2005-14 and to decline slightly in the subsequent years. The residual financing gaps will be covered by concessional loans. The expected large support from donors, if realized, would allow the government to reduce its average external borrowing from 4 percent of GDP during 2005-14 to 3 percent of GDP per year over the following years. Loans are expected to jump to US$210 million during 2015-25.

- Malawi is assumed to reach the HIPC completion point in mid-2006.

Results based on preliminary borrowing data show that:

- The baseline scenario suggests fragility of Malawi's external debt to less concessional borrowing terms.

- Under the baseline scenario, the NPV of debt-to-export ratio (current-year exports) is projected to decline from about 215 percent in 2004 to about 192 percent by 2015, and continue to decline thereafter. External debt service as percent of exports is expected to decline from 21 percent in 2004 to 8 percent in 2006, after reaching the completion point, but increases to about 14 percent in 2015.

- The bound tests reveal that Malawi's external debt indicators are sensitive to "export shocks." The NPV of debt-to-export ratio peaks at 296 percent in 2010 from 209 percent in 2005 in the baseline scenario. The debt service ratio jumps to 14 in 2015 after reaching 7 percent in 2006.

- In accordance with the World Bank's Country Policy and Institutional Assessment Indicators, Malawi is considered a medium performer. The policy-dependent indicative upper threshold for a country like Malawi is 150 percent of NPV to exports, which Malawi will reach only after 2024. This underlines the significance of borrowing at highly concessional terms and actively seek grant financing.

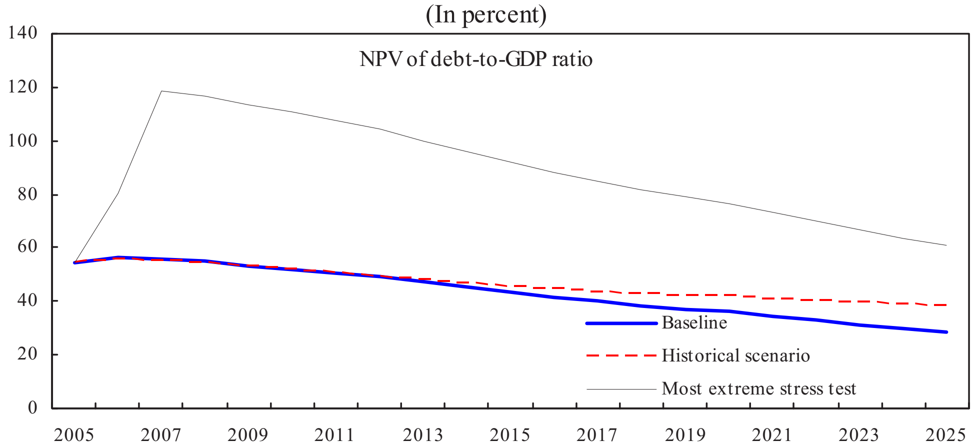
Conclusions:

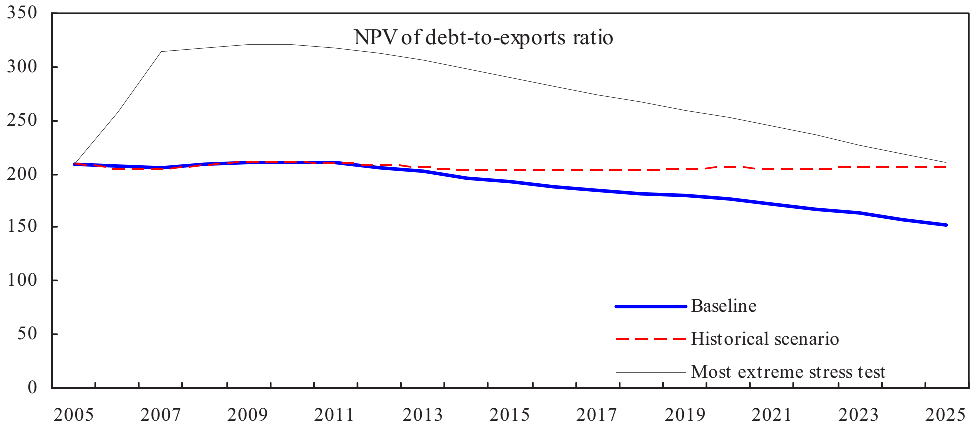
- The external debt sustainability should remain a serious concern over the medium term, even after reaching HIPC completion point. The significance of donors support and authorities commitment to prudent macroeconomic policies cannot be overstated and are critical for Malawi's external debt sustainability.

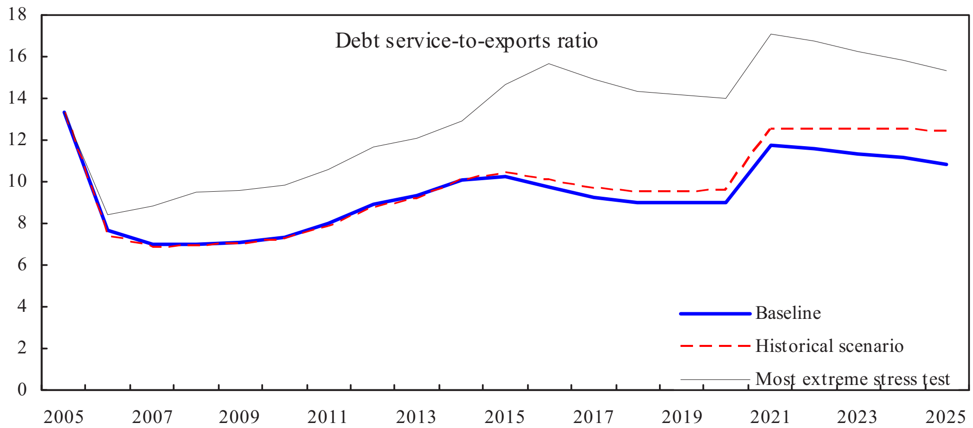
- The stress tests show that Malawi's government should follow a prudent borrowing strategy, borrowing under high concessional terms only and increasing its reliance on grants.

- Lowering dependence on tobacco and increasing diversification of exports would be key to Malawi's debt sustainability. In this context, intensification of structural reforms is vital.

Figure 1. Malawi: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005-2025
(In percent)







Source: Staff projections and simulations.

Table 1. Malawi: External Debt Sustainability Framework, Baseline Scenario, 2002-2025 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Est.	Projections								
	2002	2003	2004			2005	2006	2007	2008	2009	2010	2005-10 Average	2015	2025	2011-25 Average
External debt (nominal) 1/	**148.1**	**165.7**	**159.0**			**153.2**	**151.8**	**145.2**	**138.3**	**130.8**	**124.2**		**93.5**	**57.5**	
o/w public and publicly guaranteed (PPG)	148.1	165.7	159.0			153.2	151.8	145.2	138.3	130.8	124.2		93.5	57.5	
Change in external debt	-15.2	17.5	-6.7			-5.8	-1.4	-6.5	-7.0	-7.5	-6.6		-5.4	-2.7	
Identified net debt-creating flows	-9.6	18.9	-3.5			16.6	9.0	4.5	3.4	2.7	2.8		0.7	0.0	
Non-interest current account deficit	**10.0**	**6.0**	**6.4**	**5.0**	**4.4**	**4.9**	**2.5**	**4.2**	**5.0**	**4.7**	**4.8**		**3.1**	**1.6**	2.8
Deficit in balance of goods and services	13.4	17.7	20.2			23.0	19.0	18.7	18.2	18.6	17.8		14.8	11.0	
Exports	24.0	26.9	25.9			26.1	27.2	27.1	26.3	25.3	24.6		22.5	18.7	
Imports	37.5	44.6	46.1			49.1	46.2	45.8	44.5	43.9	42.5		37.3	29.7	
Net current transfers (negative = inflow)	-12.5	-17.2	-17.6	-9.5	4.9	-20.5	-19.9	-18.7	-17.2	-17.5	-16.4		-14.6	-11.6	-13.7
Other current account flows (negative = net inflow)	9.1	5.5	3.9			2.4	3.4	4.2	4.0	3.6	3.4		2.8	2.1	
Net FDI (negative = inflow)	**-1.9**	**-2.4**	**-2.3**	**-1.6**	**0.9**	**-1.3**	**-1.4**	**-1.4**	**-1.4**	**-1.4**	**-1.3**		**-1.1**	**-0.9**	-1.0
Endogenous debt dynamics 2/	**-17.7**	**15.3**	**-7.6**			**13.0**	**7.9**	**1.7**	**-0.2**	**-0.7**	**-0.7**		**-1.2**	**-0.7**	
Contribution from nominal interest rate	1.2	1.5	1.5			1.0	0.7	0.6	0.6	0.6	0.6		0.5	0.4	
Contribution from real GDP growth	5.6	29.4	10.1			12.0	7.3	1.0	-0.8	-1.3	-1.2		-1.7	-1.1	
Contribution from price and exchange rate changes	-24.5	-15.7	-19.3			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**-5.6**	**-1.3**	**-3.1**			**-22.4**	**-10.4**	**-11.0**	**-10.4**	**-10.2**	**-9.4**		**-6.2**	**-2.7**	
o/w exceptional financing	-1.6	-2.7	-2.6			-2.3	-1.2	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	...	...	55.7			54.6	56.2	55.7	54.8	53.4	52.1		43.2	28.6	
In percent of exports	...	...	214.7			209.1	206.7	205.6	208.6	210.9	211.4		192.2	152.8	
NPV of PPG external debt	**...**	**...**	**55.7**			**54.6**	**56.2**	**55.7**	**54.8**	**53.4**	**52.1**		**43.2**	**28.6**	
In percent of exports	...	...	214.7			209.1	206.7	205.6	208.6	210.9	211.4		192.2	152.8	
Debt service-to-exports ratio (in percent)	17.1	20.0	21.2			13.3	7.7	7.0	7.0	7.1	7.3		10.3	10.9	
PPG debt service-to-exports ratio (in percent)	17.1	20.0	21.2			13.3	7.7	7.0	7.0	7.1	7.3		10.3	10.9	
Total gross financing need (billions of U.S. dollars)	235.8	159.5	180.3			142.3	66.0	105.3	132.3	135.9	149.2		176.9	246.4	
Non-interest current account deficit that stabilizes debt ratio	25.2	-11.5	13.1			10.7	3.9	10.8	12.0	12.2	11.4		8.5	4.3	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-3.9	-18.2	-6.5	-17.7	15.7	-8.0	-5.0	-0.7	0.6	1.0	1.0	-1.8	1.9	1.9	1.8
GDP deflator in US dollar terms (change in percent)	17.6	11.8	13.1	30.8	21.7	15.9	9.6	8.4	7.3	7.2	6.6	9.2	6.0	6.0	6.0
Effective interest rate (percent) 5/	0.8	0.9	1.0	1.3	0.3	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.7	0.6
Growth of exports of G&S (US dollar terms, in percent)	-1.9	2.4	2.1	3.1	8.5	7.3	8.5	7.2	4.6	4.3	4.9	6.2	5.7	6.6	6.0
Growth of imports of G&S (US dollar terms, in percent)	24.3	8.9	9.4	6.7	19.7	13.6	-1.5	6.8	4.7	7.0	4.2	5.8	5.4	5.4	5.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	51.3	47.5	48.9	50.9	52.5	52.5	50.6	53.9	55.4	54.5
Memorandym item:															
Nominal GDP (billions of US dollars)	1940.5	1775.4	1879.2			2003.1	2087.6	2245.7	2424.2	2625.5	2828.0		4130.7	8939.6	

Source: Staff simulations.

1/ Includes both public and private sector external debt.

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

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

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

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

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

Table 2. Malawi: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005-25
(In percent)

	Est.	Projections						
	2005	2006	2007	2008	2009	2010	**2015**	2025
NPV of debt-to-GDP ratio								
Baseline	55	56	56	55	53	52	**43**	29
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	55	55	55	54	53	52	**46**	38
A2. New public sector loans on less favorable terms in 2006-25 2/	55	58	58	58	58	58	**52**	42
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	55	80	118	116	113	111	**92**	61
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	55	58	60	59	58	56	**47**	30
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	55	56	56	55	53	52	**43**	29
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	55	64	70	69	67	65	**54**	33
B5. Combination of B1-B4 using one-half standard deviation shocks	55	74	101	99	96	93	**77**	46
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	55	77	77	75	73	72	**59**	39
NPV of debt-to-exports ratio								
Baseline	209	207	206	209	211	211	**192**	153
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	209	204	204	207	210	211	**203**	206
A2. New public sector loans on less favorable terms in 2006-25 2/	209	212	215	223	229	234	**233**	227
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	209	207	206	209	211	211	**192**	153
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	209	244	289	292	295	296	**269**	207
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	209	207	206	209	211	211	**192**	153
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	209	234	258	261	263	263	**239**	174
B5. Combination of B1-B4 using one-half standard deviation shocks	209	258	314	318	320	320	**290**	210
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	209	207	206	209	211	211	**192**	153
Debt service ratio								
Baseline	13	8	7	7	7	7	**10**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	13	7	7	7	7	7	**10**	12
A2. New public sector loans on less favorable terms in 2006-25 2/	13	8	7	8	8	8	**11**	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	13	8	7	7	7	7	**10**	11
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	13	9	9	9	10	10	**14**	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	13	8	7	7	7	7	**10**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	13	8	7	8	8	8	**12**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	13	8	9	10	10	10	**15**	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	13	8	7	7	7	7	**10**	11
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	53	53	53	53	53	53	**53**	53

Source: Staff projections and simulations.

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

Table 3: Malawi: Breakdown of the increase of NPV of Debt-to-Exports Ratio as of end-2004 1/

	Percentage Points	Percent of total increase
NPV of debt-to-exports ratio (as projected at decision point)	**172.6**	
NPV of debt-to-exports ratio (actual)	**231.0**	
Total increase	**58.4**	**100%**
1. Due to changes in the parameters	**55.7**	**95%**
o/w due to changes in the discount rates	38.6	66%
o/w due to changes in the exchange rates	17.1	29%
2. Due to unanticipated new borrowing	**0.9**	**1%**
o/w due to higher than expected disbursements	(1.6)	-3%
o/w due to lower concessionality of the loans	2.4	4%
3. Due to changes in exports	**22.5**	**39%**
5. Other factors 2/	**(20.7)**	**-35.4%**

Sources: Staff estimates

1/ NPV of debt-to-revenue ratio after enhanced HIPC assistance.
2/ Due to revisions in the DP classification of bilateral debt and changes in the timing and mechanisms of delivery of assistance compared to the assumptions in the decision point projections.
3/ After full delivery as of end-2003.

MALAWI: HIPC COMPLETION POINT TRIGGERS UPDATE – MAY 2005

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

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

The debt relief will become irrevocable only after Malawi reaches the completion point. Prior to that time, Malawi is receiving interim relief, which cannot exceed one third of the total assistance to be provided by IDA (in NPV terms). Hence, Malawi will likely cease to benefit from interim debt relief by 2006/07 at the latest.

The completion point can be reached if Malawi achieves:

(i) **Satisfactory macroeconomic performance (as demonstrated by a minimum 6-months track-record under a new PRGF arrangement):** Good performance under the SMP started in June 2004 may lead to a new PRGF in July 2005. Hence a track-record of macroeconomic stability under a new PRGF could be established by January 2006 at the earliest.

(ii) **One-year satisfactory MPRSP implementation:** The full MPRSP was completed in April 2002 (and endorsed by the Boards in August 2002). The first Annual Progress Report was approved by the Boards in October 2003 indicating that MPRSP implementation was limited. The second APR and JSAN (looking at the period July 2003-June 2004) will be submitted to the Boards in mid-2005 and will again indicate that MPRSP implementation has been limited. The third APR (looking at the period July 2004-June 2005) is expected in late 2005. Thus satisfactory one-year implementation of PRSP could be met at the earliest in late 2005.

(iii) **Satisfactory implementation of the outstanding completion point triggers** (see details in the next two pages): Substantial progress has been made towards meeting the completion point triggers. However, several important triggers remain outstanding. Since some of these triggers are likely to require well in excess of 12 months of sustained work, it is critical that the government focuses on the outstanding triggers immediately in order not to delay reaching the completion point.

Completion Point Triggers Still Outstanding:

Specific triggers still outstanding	Status and actions to accelerate
Public expenditure	
• Implement IFMIS in four pilot ministries.	• Unclear. IFMIS was piloted in four ministries but never became operational. Government has now decided to change the software and will restart IFMIS piloting and roll out to all ministries.
Safety nets:	
• A rationalization and prioritization of existing and new programs, under the National Safety Net Strategy.	• Partially met. Concept paper approved by cabinet in February 2002. Safety nets unit has been created but not yet coordinating safety nets policy. Inception phase with DfID assistance ongoing, but limited progress so far.
• Establishment of a monitoring and evaluation of the National Safety Net Strategy	• Partially met. Monitoring and evaluation of some individual projects is carried out, but evaluation of overall policy has not started.
• Transform universal starter-pack distribution into a Targeted Input Program (TIP) for 2001/02	• Unclear. Decision to revert to almost universal TIP (mainly donor funded) in 2002/03 and 2003/04 as result of food crisis. However TIP has now been abolished and government is planning a generalized fertilizer price subsidy in 2005/06.
Health	
• Completion of 'phase one' reforms of the Central Medical Stores (CMS).	• Work on this issue has proceeded slowly. Reforms being discussed in context of Health SWAp.
• A share of health expenditure of at least 13% of discretionary recurrent budget	• Unclear. Respectively, 15.2% for 2001/02 (revised budget) and 18.4% for 2002/03 (budget), but has decreased in recent years.
Education	
• Yearly enrolment of 6000 students for teacher training and institution of in-service training for primary teachers (at least once each year).	• Not met. Only about 2850 teachers graduated in 2001/02 and 3150 teachers in 2002/03, and approximately 3000 in 2003/04.
• Reallocate budgetary resources from secondary school boarding (except for special needs education) to teaching and learning materials.	• Not met. Secondary schools are still operating as boarding.
• Share of education sector[1] expenditure in discretionary recurrent budget of at least 23%	• Unclear. Respectively, 29.1% for 2001/02 (revised budget) and 29.1% for 2002/03 (budget), but has decreased in recent years.
Land Policy	
• Submission of draft Land Law to parliament.	• Not met. Land policy adopted by cabinet in January 2003; submission of Land Law to Parliament expected in 2005.
Micro finance	
• Establishment of a monitoring system covering all micro-finance institutions.	• Not met.

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

Completion Point Triggers Already Met:

Area and specific triggers	Status and actions to accelerate
Public expenditure	
• Quarterly expenditure reporting as per format jointly developed by MOF/IDA.	• Met. Format agreed. Pro-poor expenditures are published on the government web site.
1.	
Micro finance	
• Approval by Cabinet of the 'Micro-finance Policy'.	• Met. Policy approved at end-October 2002.
• Increase number of micro-finance clients by 20%.	• Probably met. (Difficult to verify).
Governance	
• Separation of fiscal management and audit functions under new legislation.	• Met. New Audit Act and Financial Management Act have been approved by Parliament in May 2003. The Procurement Act has also been passed in May 2003
Health	
• Recruitment, training and deployment of at least 200 hundred nurse technicians, 50 new medical assistants and 20 radiography technicians per annum.	• Met. Currently training over 500 nurses technicians; 130 medical assistants and 20 radiography technicians, respectively.
• Budget for drugs and medical supplies in line with BHA standard (US$1.25 per capita).	• Met. Drugs budget at $1.44 and $1.23 in 2001/02 and 2002/03 respectively, broadly in line with BHA standard.
HIV/AIDS: Implementation of National Aids Strategy.	
• Fully staffed, functional and autonomous National AIDS Control Secretariat.	• Met. National AIDS Secretariat has been operational since end-2001. Need for additional staffing to enhance NAC' coordination effectiveness.
• 75% of all condom outlet points with condoms in stock at any given time.	• Met. 80% availability in grocery shops, and 65 percent availability in public hospitals. (Difficult to verify)
• Continuous availability of testing kits at all blood transfusion sites by increasing blood testing kits from 1500 to 2500.	• Met. More than 3000 testing kits have been supplied by end-2003.
• Implementation of an effective Behavior Change Communication Strategy.	• Met. Implementation of communication strategy has started.
• Syndromic Management of sexually transmitted infections (STI) in all Central, District and major CHAM hospitals.	• Met.
Education	
• Pre-packaging of donor-supplied primary textbooks for each school and direct supply from the supplier to the schools.	• Met. Donor-supplied textbooks are pre-packed and directly supplied.

Statement by the IMF Staff Representative
August 5, 2005

This statement provides additional information that has become available since the issuance of the staff report. Recent developments are consistent with the program and do not alter the thrust of the staff appraisal. The staff has received written notification that the two prior actions—parliamentary approval of the budget and implementation of a new pension formula—have been completed.

- The 2005/06 budget approved by parliament on July 15 is consistent with the program and the staff report. Budget implementation is moving forward, and it is now likely that the World Bank will disburse up to US$30 million for emergency assistance—US$20 million was reported in the staff report. The modalities of this grant are under discussion, but the authorities have indicated that the additional funds will be used to reduce domestic debt, therefore strengthening the macroeconomic objective of lowering domestic debt to less than 15 percent in the medium term. The impact on the budget of this initiative, a few minor changes in the spending plan—which do not change total spending or pro-poor expenditures—and tax reforms, will be evaluated during the first program review.

- On July 25, the cabinet approved the new pension formula that calculates the base salary for pension payments as the average of the last five years. This effectively reduces the impact of the wage reform implemented in October 2004 on pension payments. A circular was issued to ministries on July 26 with immediate effect.

- Recent estimates point to a larger decline in the food crop than previously anticipated. Donors have provided assurances of additional resources to cover the higher food shortfall without recourse to government resources. Staff will explore the implications of the revised estimates and the aid modalities at the time of the first review.

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FOR IMMEDIATE RELEASE
August 5, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$55.9 Million Three-Year Arrangement for Malawi Under the PRGF and Additional Interim Assistance Under the Enhanced HIPC Initiative

The Executive Board of the International Monetary Fund (IMF) today approved a three-year arrangement for Malawi under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 38.17 million (about US$55.9 million) to support the government's program of economic reform and poverty reduction through private sector-led growth. The first disbursement under the program will amount to SDR 5.4 million (about US$7.9 million).

The Executive Board also approved an additional amount equivalent to SDR 4.628 million (about US$6.8 million) in interim assistance from the IMF under the Heavily Indebted Poor Countries (HIPC) Initiative to be applied in broadly equal amounts in the remainder of 2005 and the first half of 2006.

The last PRGF arrangement for Malawi was approved in December 2000, (see Press Release No. 00/79) and expired in December 2004 after only one review was completed. The authorities subsequently requested a staff-monitored program covering July 2004 to June 2005 to build a performance track record. Performance under the SMP to date has been satisfactory.

In commenting on the Executive Board's discussion on Malawi, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair stated:

"Malawi's economic performance has improved since mid-2004 under the program monitored by Fund staff. After several years of economic deterioration, significant progress has been made in restoring macroeconomic stability, strengthening economic growth, and stabilizing the government's domestic debt. The government is committed to continued strong policy implementation, especially budget implementation, to consolidate these gains.

"The authorities' new three-year economic program emphasizes policies and reforms to promote a sound macroeconomic environment and private sector development. These are necessary for sustained poverty reduction and economic growth in Malawi. Priority will also be given to sharply reducing the domestic debt in order to free resources for priority areas and to further reduce real interest rates. The authorities will need to remain vigilant in containing inflationary pressures. Implementation of structural reforms will be a key determinant of sustained poverty reduction.

"In light of the recent drought conditions, food security is an overarching priority of the government. Permanent measures will need to be put in place to ensure food security in the future.

"Since taking office in May 2004, the government and stakeholders have worked together to enhance the implementation of strategies to strengthen economic growth and to set priorities for tax reform. The government is currently updating its poverty reduction strategy to reflect these developments as well as scaled-up donor support for the health sector," Mr. Kato said.

ANNEX

Recent Economic Developments

Malawi is one of the poorest countries in Africa. Two-thirds of the population live in poverty; the incidence of malaria is very high; and approximately 15 percent of the adult population is infected with HIV. Significant progress toward the Millennium Development Goals (MDGs) will require sustained aid inflows.

Malawi's economy improved during 2004, but unfortunately, prospects for 2005 have been affected by a dry spell early in the year. Real GDP growth rose from less then 4 percent in 2003 to 4.5 percent in 2004 due to a rebound in tobacco production. However the drought in early 2005 is estimated to have cut the harvest of Malawi's food staple—maize—by about 25 percent, causing a potential humanitarian crisis in addition to dampening overall economic growth prospects to about 2 percent this year

Core (nonfood) inflation fell to 13.25 percent at the end of 2004, from more than 20 percent at the end of 2003. Food price inflation rose over the period, causing an increase in overall consumer price inflation. The early 2005 drought is expected to push up food prices temporarily later in the year and the depreciation of the kwacha is expected to be partially passed through to nonfood prices.

Program Summary

The government's economic program aims to promote growth by fostering a financially sound and stable macroeconomic environment and by undertaking structural measures to improve economic efficiency. The program will build on recent successes in macroeconomic stabilization and on strengthening public institutions and infrastructure. Policies are guided by the objectives set out in Malawi's 2002 Poverty Reduction Strategy Paper (PRSP) that identify economic growth, especially in the rural areas as the best way to alleviate poverty.

The government's main economic objectives over the next three years are to raise economic growth to near 6 percent a year, with an emphasis on rural incomes, to increase health services and educational opportunities, to reduce core inflation to the 5–8 percent range, to run a fiscal surplus to reduce the government's domestic debt to less than 15 percent of GDP from over 24 percent, and to build international reserves to at least two months of imports.

To these ends, fiscal policies will aim at reducing the government's absorption of domestic resources while allowing for increases in pro-poor and pro-growth spending. It is expected that this will help ease pressures on real interest rates and allow for the maintenance of a competitive exchange rate. The structural reform agenda will include measures to improve macroeconomic policy implementation, and to increase overall economic efficiency, such as the repair and expansion of the existing road network, the completion of an interconnector from the Cahorra Bassa hydroelectric dam, and the sale of Malawi Telecom.

In view of Malawi's critical external debt sustainability, even after reaching the HIPC completion point, the authorities are committed to obtain or guarantee only concessional loans and to make every effort to secure grants.

Malawi became a member of the IMF on July 19, 1965; its quota is SDR 69.4 million (about US$101.7 million), and its outstanding use of IMF credit currently totals SDR 54.4 million (about US$ 79.8 million).

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a PRSP. This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Table 1. Malawi: Selected Economic Indicators, 2002-07

	2002	2003	2004		2005	2006	2007
	Est.	Est.	SMP	Est.	Proj.	Proj.	Proj.
National income and prices							
GDP at constant factor prices	2.1	3.9	3.9	4.6	2.1	8.2	5.6
Nominal GDP per capita (in U.S. dollars)	163.0	145.8	...	152.2	158.2	162.4	171.2
GDP deflator	16.6	9.2	14.7	11.6	16.2	10.2	8.4
Consumer prices (end of period)	7.6	9.8	20.0	13.7	16.9	3.9	7.0
Food	4.5	3.0	...	14.1	19.2	0.5	7.0
Nonfood	11.2	20.2	...	13.2	13.8	8.7	7.1
Investment and savings (percent of GDP)							
National savings	-0.8	3.3	1.9	3.2	10.4	12.7	11.3
Of which: domestic savings	-11.0	-11.6	-3.5	-12.0	-8.1	-5.2	-5.7
unrequited transfers	12.6	17.3	7.6	17.6	20.6	19.9	18.7
Gross investment	10.4	10.9	11.1	11.2	16.4	15.9	16.1
Foreign savings	-11.2	-7.6	-9.2	-8.0	-6.0	-3.2	-4.8
Central government (percent of GDP)							
Revenue (excluding grants)	17.7	22.0	...	23.6	24.8	24.2	24.3
Expenditure	35.1	39.3	...	41.1	48.3	41.3	39.8
Of which: domestic expenditure	27.8	29.8	...	32.1	35.7	29.3	28.4
Underlying balance 1/	-2.8	-0.5	...	1.0	-1.5	2.2	1.6
Domestic balance	-10.1	-7.8	...	-8.5	-11.1	-5.1	-4.1
Overall balance	-11.6	-6.5	...	-5.9	-4.6	-0.8	-0.3
Money and credit (change in percent of beginning-of-year M2)							
Money and quasi money	25.2	29.3	25.5	29.8	16.1	18.4	15.7
Net foreign assets	-55.4	21.5	1.8	6.0	10.8	18.0	7.2
Net domestic assets	80.6	7.8	23.8	23.8	5.3	0.4	8.5
Credit to the government	45.1	11.3	36.4	10.3	17.4	-2.2	-2.8
Credit to the rest of the economy	4.1	8.1	1.2	11.3	4.9	4.7	7.9
Velocity	5.4	4.9	4.6	4.5	4.5	4.6	4.5
External sector (millions of U.S. dollars)							
Exports, f.o.b.	421.1	440.6	476.4	470.4	536.4	571.5	591.0
Imports, c.i.f.	-726.8	-791.6	-703.0	-866.2	-983.7	-963.6	-1,029.3
Usable gross official reserves	103.4	115.6	84.8	119.3	142.2	210.8	233.8
(months of imports)	1.4	1.5	1.3	1.3	1.6	2.3	2.4
Nominal effective exchange rate 2/	-34.4	-30.2	...	-7.7	-1.3	...	...
Debt stock and service (percent of GDP)							
External debt (public sector)	143.3	158.9	160.7	150.0	143.7	139.3	131.0
NPV of debt (percent of avg. exports)	299.3	295.0	...	291.0	274.4	255.8	240.9
External debt service (percent of exports)	18.3	21.8	21.1	22.9	18.9	21.8	20.3
Net domestic debt (central government)	17.4	22.3	27.3	22.9	22.0	18.0	15.0
Domestic interest payment	4.0	7.9	...	8.5	6.2	5.0	3.7

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

1/ A measure of domestic adjustment effort (i.e., domestic primary balance excluding maize and the Health SWAp). Definition: Overall balance plus statistical discrepancy, excluding grants, revenue and expenditure from maize, interest, foreign-financed development expenditures, and the Health Swap.

2/ Based on data through April 2005.

Statement by Peter J. Ngumbullu, Executive Director Malawi
and John Steytler, Advisor to Executive Director
August 5, 2005

- *Malawi's performance under the SMP has been strong, supported by the implementation of prudent fiscal and monetary policies. All quantitative targets were met and implementation of structural reforms has improved significantly. The authorities are committed to sound economic and financial policies and a policy of zero tolerance against corruption. They request the support of the Executive Board for a three-year PRGF arrangement, as well as additional interim assistance under the HIPC Initiative.*
- *The overarching objectives of the authorities' medium-term program, which is in line with their poverty reduction strategy and the recommendations of the EPA, is to reduce poverty by fostering an environment conducive to private–sector-led growth.*
- *The major objective of fiscal policy during the program period will be domestic debt reduction to lower interest rates, debt service costs and create fiscal space for pro-poor expenditure to improve chances of reaching the MDGs by 2015. Efforts will be enhanced to strengthen public expenditure management and tax administration during the medium-term.*
- *Under the new program, the independence of the central bank will be strengthened, monetary policy will be targeted to low and stable inflation, the exchange rate will be fully market determined and reserves increased close to three months of import cover.*
- *The authorities are committed to creating an environment conducive for private-sector-led development. They have revised their privatization master plan, which includes full privatization of many state owned enterprises, and closure of some, promotion of public-private partnerships and mergers, and commercialization.*
- *The trade regime will continue to be liberalized, and regional integration will be enhanced. Efforts to support diversification of the economy will continue, with medium-term agricultural policies to ensure food security for all Malawians.*

Introduction

1. The Malawian authorities appreciate the candid exchange of views during discussions of their performance under the staff-monitored program (SMP) and an economic program for 2005-08 to be supported under a new PRGF arrangement. They agree with the thrust of the staff assessment, which gives a fair account of recent economic developments in Malawi and the challenges ahead. The authorities request the support of Executive Directors for a new PRGF-supported program and additional interim assistance under the HIPC Initiative.

2. Malawi's performance under the SMP has been strong; a performance that is attributed to the implementation of prudent fiscal and monetary policies reflecting the authorities' renewed commitment to macroeconomic stability. All quantitative targets were observed, and implementation of structural reforms has improved significantly, reflecting renewed commitment and the formulation of more realistic program objectives as recommended following the Ex-Post Assessment (EPA) of the Fund's involvement in Malawi.

3. The authorities are determined to continue with good financial management and create an environment conducive to private sector development. In the short to medium term, the authorities are focusing on domestic debt repayment, strengthening of public expenditure management and procurement procedures, and private sector development. The authorities are fully committed to the steadfast implementation of these principles to assist them achieve the objectives set out in their Malawi Poverty Reduction Strategy of 2002.

Recent Economic Developments

4. Economic growth accelerated in 2004, following of a rebound in tobacco production. However, the prospects for 2005 have been dampened somewhat due to an early drought, which led to a decline of about 25 percent in maize harvest, causing a potential humanitarian crisis. Core inflation fell to 13¼ percent at end-2004 from over 20 percent at end of the previous year. The early drought in 2005 is expected to push food prices up temporarily later in the year. The real effective exchange rate remained stable since August 2003. The deficit on the external current account, however, widened during 2004, despite a large increase in tobacco production, as auction floor prices were lower than anticipated under the SMP and deliveries slowed down. Imports increased strongly in line with strong economic expansion, as well as on account of higher world petroleum and fertilizer prices. Nevertheless, the authorities managed to maintain the level of foreign reserve cover at 1.4 months of imports, but realize that this will have to be increased in the future.

The Medium-Term Reform Strategy

5. The overarching objective of the medium-term program is to reduce poverty by fostering an environment that is conducive to private-sector-led growth. The medium-term program is in line with Malawi's poverty reduction strategy (MPRSP), the Ex-Post Assessment's recommendations, and the experienced gained during implementation of the SMP. The approval of a new PRGF arrangement will help unlock the much needed donor support, including under the HIPC Initiative, to enable Malawi reach the MDGs by 2015.

Fiscal Policy

6. The most important objective of fiscal policy during the program period will be domestic debt reduction and improved fiscal management. Borrowing over the past several years

has pushed their net debt to more than one-quarter of GDP. In this connection, the target is to reduce domestic debt to 15 percent of GDP or less by 2008. With these measures, it is expected that domestic debt service will fall to near 5 percent of GDP in 2005/06 from over 7 percent of GDP in 2004/05. External debt service, which is currently about 1½ percent of GDP, is expected to decline moderately upon reaching the completion point next year. This will also allow interest rates to decline in line with the improved track record of sound fiscal policies and an improvement in confidence. Over time, the authorities will aim to lengthen the maturity structure of debt stock, and make their budget more stable and predictable. The authorities are calling development partners to provide assistance with measures that will reduce their domestic debt, which is exerting a heavy fiscal burden to the government.

7. Efforts to strengthen public expenditure management will continue during implementation of the program, based on a two-pronged approach. In the near term, efforts will be increased to restore the management systems that have worked well, including accurate monthly expenditure returns, respect for funding ceilings, and the application of approved accounting standards. Over the medium term, the authorities will be implementing an integrated financial management system.

8. With regard to tax policies and tax administration, the authorities have recently completed a general review with the objective of making the system more competitive and business friendly. While they would like to reduce the overall tax burden, they realize that there is little room to do so now, given the current level of spending and their determination to lower the debt burden. Over the medium-term, efforts will be increased to rationalize and restructure government activities to make room for private sector growth.

Monetary and Exchange Policy

9. The authorities intend to further strengthen the independence of the Reserve Bank of Malawi in order to enhance credibility of monetary policies. The objective of monetary policy is to bring inflation to 5-8 percent range, over the medium-term. They believe that within this range, inflation would be less likely to distort saving and investment decisions. The Reserve Bank of Malawi will continue to target broad money stock as the nominal anchor to control inflation. It will use a combination of open market operations and foreign exchange sales to influence liquidity conditions.

10. With regard to the exchange rate system, the authorities remain committed to a fully market determined exchange rate. In this regard, they will continue to smoothen seasonal fluctuations of the exchange rate and refrain from attempting to influence its underlying value, recognizing that the most important ingredient for exchange rate stability is sound economic policies, especially prudent fiscal policy. They will strive to increase their level of international reserves to above three months of import cover.

Structural Reforms and Privatization

11. Malawi is fully committed to creating an environment for private sector development and privatization of some of the remaining state enterprises to bolster their efficiency, improve services and potentially provide revenue to government. The delay of privatization was necessary to assure Malawians that the sale of state owned enterprises is beneficial and less costly to the public and that resources will not be wasted. The Government has, however, revised their divesture master-plan, which makes provision for out-right sale of a number of state owned enterprises, closure of some; promotion of public-private partnerships and mergers, and commercialization of those state-owned enterprises where full privatization would lead to social concerns.

External Policies

12. The authorities are aware that heavy reliance on tobacco as the main export commodity leaves Malawi extremely vulnerable to external shocks and local weather conditions. In this connection, they have included in their growth strategy initiatives to bolster non-tobacco exports. A key element in the authorities' diversification strategy is creating a liberal trade regime and regional integration. In this context, a revised Trade Agreement was signed with Zimbabwe in March 2005, while negotiations with COMESA and SADC to further trade liberalization are at an advanced stage. In addition, the authorities are studying the impact of the proposed COMESA Common External Tariff on industry competitiveness, revenue and employment.

13. The authorities are seriously concerned about the erosion of trade preferences on their diversification efforts. They see for example, the pending elimination of the EU sugar regime in 2008 could adversely impact on the second largest export of Malawi. Although textiles and clothing exports are of lesser importance, the authorities have been closely monitoring the expiration of the global quota restrictions on textiles and clothing in December 2004.

Food Security

14. The objective for food security policy is to ensure that all Malawians have sufficient food for healthy and active life. Unfortunately, the country's dependency on rain-fed agriculture, with changing weather patterns, growing population, and the increased incidence of HIV/AIDS, have increased Malawi's vulnerability to food insecurity. In going forward, the authorities' medium-term agricultural policies will be based on market principles. In this connection, the authorities will continue to improve the functioning of markets, including removing practices that restrict free competition in produce, food and input markets. The strategy is to improve the availability of fertilizer and other inputs at reasonable market prices and on time to ensure farmers have easy access to markets for products. The authorities are also looking at ways to promote agricultural irrigation involving the private sector and local communities, better agricultural research and extension services, and transport and other infrastructure. They are also committed to

ensuring that pubic resources to support the agricultural sector will be provided based on fiscal sustainability in the long term.

HIPC Completion Point

15. Malawi has a large unsustainable external debt burden that, in NPV terms at end-2004, exceeded 200 percent of exports. It will therefore be important for Malawi to reach completion point under the HIPC Initiative and lock in debt relief from creditors. The authorities are making strong efforts to meet the requirements for reaching this objective and anticipate that Malawi would be in a position to reach the completion point mid-2006.

Conclusion

16. In conclusion, the authorities appreciate the continued engagement by the Fund Management, which has been very fruitful. We want to reiterate the strong commitment of the authorities to reforms and to addressing the economic challenges facing Malawi. The authorities believe that as a result of continuing efforts they have demonstrated their commitment towards sound policies, and would like a stronger engagement with the Fund and the international community under a PRGF-supported program. They therefore look forward for a favorable consideration of their request by the Executive Board.