

Malawi: Staff-Monitored Program

This paper on the staff-monitored program paper for **Malawi** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **September 8, 2004**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Malawi** or the Executive Board of the IMF.

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INTERNATIONAL MONETARY FUND

MALAWI

Staff-Monitored Program

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

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September 8, 2004

- **PRGF.** On December 21, 2000, the Executive Board approved a three-year arrangement under the PRGF for Malawi for SDR 45.1 million (65 percent of quota). The first review was completed on October 20, 2003 and the arrangement was extended through December 20, 2004. The second review could not be completed because of fiscal slippages and delays in completing structural performance criteria.
- **Article IV discussions.** A staff team visited Lilongwe during July 21-August 2, 2004 to conduct the 2004 Article IV consultation discussions, present the ex post assessment (EPA) of Malawi's long-term engagement with the Fund, and hold talks on a staff-monitored program (SMP). The team comprised Mr. Green (head), Mr. Alvesson, Mr. Steinberg (all AFR), Mr. Baunsgaard (Resident Representative), Ms. Mongrut (PDR), and Ms. Roehler (FAD). Mr. Ghosh (PDR) presented the EPA. Ms. Gesami (OED) participated in all of the discussions. The mission held discussions with the Minister of Finance, Mr. Goodall Gondwe; the Governor of the Reserve Bank of Malawi (RBM), Dr. Ellias Ngalande; the Secretary to the Treasury, Mr. Patrick Chilambe; and other senior officials of the government and public agencies. The mission also met with donor and business representatives.
- **SMP.** In the attached letter dated September 8, 2004 (Appendix I) and the accompanying memorandum of economic and financial policies (MEFP), Malawi requests a 12-month SMP to establish a policy implementation track record that could lead to a new PRGF arrangement. The program will be monitored quarterly. During the midterm review (test date December 2004) subsequent targets will be revisited and directors' suggestions expressed during the October Board meeting could be addressed. Malawi's economic program is supported by the World Bank, the African Development Bank (AfDB), the European Union, and other bilateral and multilateral partners.
- **Work program.** The Article IV report will be presented to the Executive Board in October 2004. This provides an opportunity to discuss the SMP and the ex post assessment of Malawi's engagement with the Fund.

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Executive Summary

The authorities have requested staff monitoring of their macroeconomic program for the 2004/05 fiscal year (July-June) with a view to establishing a performance track record that could lead to a new Poverty Reduction and Growth Facility (PRGF) arrangement. The main objectives of the SMP will only be achieved if the approved 2004/05 (July-June) budget is in line with the agreed budget framework and the monetary overhang is addressed.

Fiscal slippages during March - June 2004 rendered the PRGF arrangement, which would expire in December 2004, irretrievably off-track.

Dr. Bingu wa Mutharika was elected president on May 20, 2004. In his inauguration speech, he underscored his strong commitment to macroeconomic stability and has already implemented several cost-saving measures. He also initiated anti-corruption measures.

The new government has proposed a budget framework for FY2004/05 (July-June) that would sharply reduce domestic borrowing. Primary current spending in noncore areas would be reduced in real terms, the travel budget would be cut by 25 percent, and unbudgeted spending through the special activities vote will be stopped.

The budget framework accommodates additional spending in four key areas: food security, civil service wage reform, arrears, and restructuring of the Agricultural Development & Marketing Corporation (ADMARC). These initiatives will add about 2¼ percent of GDP to current expenditures. Spending targets in other areas are tight, but appear realistic and achievable.

Fiscal slippage is a significant risk to the program. The government's ability to contain spending has deteriorated in recent years and will take some time to reestablish. Cabinet has approved the budget framework, but parliamentary passage is not assured.

Monetary policy seeks to bring inflation back into the neighborhood of 10 percent by end-2005. To meet this objective, the Reserve Bank of Malawi (RBM) will need to contain broad money growth and mop up the liquidity overhang through open market operations and selling foreign exchange once donor inflows restart.

Structural measures under the SMP will focus on public expenditure management.

I. INTRODUCTION

1. **Malawi's Poverty Reduction and Growth Facility (PRGF) arrangement was approved in December 2000, but the first review was not completed until October 2003.** This unusually long interval reflected a number of factors, in particular failure by the authorities to execute agreed budgetary and structural measures. A staff report for the second review was circulated to Directors on April 8, 2004, but was withdrawn from consideration because of spending overruns. In the event, spending during March-May 2004 exceeded the revised program that was agreed with the authorities at end-March by more than 3 percent of GDP. Much of this spending was financed by central bank borrowing, causing a sharp rise in the money supply.
2. **Dr. Bingu wa Mutharika, of the ruling United Democratic Front (UDF), was elected president on May 20, 2004, with 35 percent of the vote.** International observers concluded that the elections were free, but reported serious shortcomings, such as the misuse of government resources for campaign purposes and problems with voters' rolls. President Mutharika has stated his commitment to the reforms necessary for sustainable macroeconomic conditions and poverty reduction, and the new government has already taken measures by moving the presidency from Blantyre to Lilongwe, where ministries are currently located, and reducing the number of cabinet members in anticipation of a reduction in ministries. Mr. Gondwe, former advisor to President Muluzi and Director of the African Department in the Fund, was named Minister of Finance.
3. **Food security is again an issue.** The government estimates a maize deficit of around 250 thousand tons, owing to adverse weather conditions during the 2003/04 growing season. While large, this is significantly less than the estimated shortfall in 2001/02 that triggered large government purchases and emergency credits from the IMF and World Bank.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PRGF

4. **Economic performance has been mixed.** Owing to a reduced tobacco harvest, estimated GDP growth in 2003 has been revised down to 4½ percent, sufficient for a small real increase in per capita income, but well below the target in the program. Inflation remained near 10 percent during 2003, but edged up to 11 percent in June 2004; nonfood prices increased by 16 percent in the year, reflecting the 20 percent depreciation in the kwacha in July-August 2003 and money creation. The 2003 external current account deficit, including official transfers, is estimated at 9 percent of GDP (compared with 6 percent of GDP in the program),¹ owing mainly to lower tobacco exports.

¹ IMF Country Report No. 03/344, Malawi—First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Performance Criteria, Extension and Rephasing of the Arrangement, and Additional Interim Assistance Under the Enhanced Initiative for Heavily Indebted Poor Countries.

5. **The macroeconomic situation is precarious and adverse debt dynamics remains a serious risk.** Above-target government spending and delays in budget support (linked to policy slippages) have led to an increase in domestic financing of the budget to 8 percent of GDP in 2003/04 (July-June), compared with 3 percent repayment under the program. Monetary aggregates are also well above target, and 12-month money growth reached 36 percent by end-June 2004, compared with 10 percent under the program. The full impact of these policy slippages on the economy has yet to be seen, but already usable international reserves have fallen from 2 months of imports at end-2003 to 1½ months at end-June 2004.²

6. **The staff did not recommend completion of the second PRGF review because of policy slippages.** Discussions on the completion of the review were initiated in November 2003, but were ended in mid-April 2004 when it became clear that government spending was far above the targets established in the supplementary budget approved by parliament in March 2004. The slippages and suspension of the disbursement were unfortunate because Malawi had made some progress in meeting program objectives over the period.

7. **The underlying fiscal balance recorded a deficit of 1 percent of GDP in 2003/04, compared with a surplus of 3 percent of GDP in the program that was approved during the first review of the PRGF arrangement in October 2003.** This large slippage reflected unrestrained primary spending (6¾ percent of GDP), especially during March–May 2004. The authorities did not deliver on their commitments to reduce travel spending, to leave vacancies unfilled, to freeze promotions, and to postpone discretionary spending. Above programmed spending during the full fiscal year occurred mainly in the executive service, the national assembly, police, and military. Subventions to the University of Malawi also exceeded budgeted levels. Higher domestic interest costs and shortfalls in donor budget support added significantly to the need for domestic financing.

8. **Broad money growth was in the 30-35 percent range for most of the 2003/04 fiscal year.** The source of the expansion was central bank financing of the government deficit, especially during March-June 2004. The RBM could not mop up this injection by selling foreign currency since reserves were low, and it limited its open market operations because of concerns about imposing undue pressure on interest rates. Cash outside the banking system rose sharply on a seasonally adjusted basis during March-June 2004, further complicating monetary management.

9. **The RBM reduced the Bank Rate (discount rate) from 45 percent in late 2003 to 25 percent in June 2004.** The cut was undertaken in three steps and did not appear to affect

² Usable reserves exclude open letters of credit for 2002/03 maize operation, reserves pledged for the related bridge loan, and blocked deposits.

the RBM's ability to rollover outstanding treasury or RBM bills.³ Commercial bank lending and deposit rates have fallen in line with the Bank Rate, reducing real interest rates. The kwacha depreciated by about 20 percent against the U.S. dollar in July-August 2003, but has remained stable since then. The exchange rate has been supported by seasonal factors (tobacco exports) and by donor disbursements.

10. The authorities made significant progress on many of the structural objectives under the original program.

- Civil service wage reform is likely to be implemented in October 2004.
- The Anti-Corruption Bureau (ACB) was strengthened, and its report on maize purchases in 2002 has been finalized and forwarded to the Director of Public Prosecutions.
- The audit of domestic arrears in nine ministries (including pensions) was started in March 2004 and an interim report is near completion. The government is seeking funding to audit the remaining ministries.

III. REPORT ON DISCUSSIONS

11. Malawi's immediate economic objective is to restore macroeconomic balance through steadfast budget implementation and adherence to monetary targets. The new government has proposed a budget framework for 2004/05 that would sharply reduce domestic borrowing and lead to some repayment being made later in the year.⁴ The authorities have asked the Fund staff to monitor a program supported by this budget. Discussions on the EPA will be summarized in the upcoming Article IV report. Lessons pertaining to short-term stabilization—in particular the need for achievable targets—have been incorporated into the SMP.

12. The near-term economic outlook has been revised to reflect recent developments:

³ It is possible that treasury bill yields have not reflected market-clearing conditions. The RBM places an effective ceiling on treasury bill yields by rejecting any bids that would yield above the Bank Rate. There is also an effective floor on yields because of (i) the government's weak fiscal position; and (ii) the RBM's need to resell treasury bills that were not picked up in weekly auctions in order to meet NDA targets.

⁴ The Minister of Finance submitted a budget to Parliament on September 3, 2004. The budget submission is in line with the framework presented in this report. Debate is expected to last about three weeks.

- Real GDP growth would be around 4 percent in 2004 as high interest rates and adverse weather conditions in some parts of the country have dampened growth prospects.
- Inflation would rise to about 20 percent by the end of 2004, mainly reflecting the monetary expansion rate in 2003 and the first half of 2004, the poor maize harvest, and rising world oil prices.
- Reserves would remain around 1½ months of imports through end-2004, as foreign exchange would be sold as part of the sterilization effort.

A. Fiscal Policies

13. **The 2004/05 framework targets a decline in central government net domestic debt relative to GDP of about 2 percent of GDP.**⁵ This would be accomplished by a containment of spending, except in several new priority initiatives, buoyant tax revenue, and a sizable increase in concessional borrowing (see table below). The fiscal effort measured by the underlying balance in this framework equals 2 percent of GDP.⁶ The authorities have taken the following steps to support this framework:

- Ministries were instructed to cut the travel budget by 25 percent relative to the 2003/04 supplementary budget. This measure, supported by the President's move to Lilongwe, could save approximately MK 550 million (¼ percent of GDP).
- About MK 1 billion (about ¾ percent of GDP) would be saved in the domestically financed development budget by focusing on projects already underway and postponing new projects.
- The vote for "special activities" has been dropped. In the past, Ministry of Finance authorized spending through this vote was a prime source of unbudgeted spending. Ongoing and one-off expenditures previously financed from this vote are now included in each ministry's vote.
- Increases in user fees are being considered.
- The government agreed not to implement any tax cuts prior to the mid-year review (see para. 16). Currently under consideration are: the abolishment of the

⁵ Domestic debt held outside of the RBM, including RBM bills, is projected to increase by ½ percent of GDP over the fiscal year.

⁶ The underlying balanced is defined as overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize, plus foreign financed development expenditures.

top individual income tax rate (40 percent), an adjustment to the income tax brackets, and a small reduction in the surtax rate. The authorities will request technical assistance from FAD to study the impact of such changes on efficiency, equity, and revenue.

- Domestic debt interest would fall from 9½ percent of GDP in 2003/04 to under 8 percent in 2004/05, reflecting nominal GDP growth and the 10 percentage point reduction in interest rates in late 2003 and the second 10 percentage point reduction in June 2004. Because of the maturity structure of the debt, the interest bill in 2004/05 is largely governed by these reductions. However, the fiscal projection assumes that the Bank Rate would be increased temporarily from 25 percent to 35 percent during the year due to heavy borrowing during July-October and the projected rise in inflation that would reduce real interest rates.

Malawi: Fiscal performance, FY 2004/04 - 2004/05
(In percent of GDP)

	FY 2003/04 Prel.	FY 2004/05 SMP	Difference
Revenue	23.5	24.0	0.5
Grants	12.5	11.7	-0.8
Total expenditure	43.3	40.0	-3.3
Interest	11.0	9.0	-2.0
Primary expenditure	32.3	31.0	-1.3
Policy initiatives (increases)			
Wages and salaries	6.8	7.1	0.3
Food security	0.3	2.5	2.2
ADMARC	0.2	0.6	0.4
Communication equipment	0.0	0.5	0.5
Savings			
Other goods and services	7.9	7.4	-0.5
Arrears	0.7	0.2	-0.5
Elections	1.1	0.0	-1.1
Domestic development budget	1.8	1.0	-0.8
Other subsidies and transfers	3.9	3.9	0.0
Foreign development budget	9.5	7.8	-1.7
Overall balance	-7.3	-4.3	3.0

Sources: Malawi authorities; and IMF staff estimates.

14. **Savings from moving the presidency from Blantyre to Lilongwe—where ministries are presently located—and from a reduction in the number of ministries were not explicitly included in the budget.** Except for the reduction in travel budget, the authorities chose not to plan on these savings at this stage because they had not been reliably estimated. They did indicate that savings of 1 to 2 percent of GDP could be expected after a transition period. Similarly, revenue increases related to civil service wage reform that will

shift compensation from allowances to taxable income are only partially included in the budget at this time (see below).

15. The budget framework accommodates spending and reforms in four areas of high priority to the government: food security, civil service wage reform, arrears, and ADMARC restructuring. These initiatives (excluding wage reform) will add about MK 4½ billion (2¼ percent of GDP) to expenditures and would partly offset the savings measures above.

- The targeted input program (TIP) will be expanded to cover nearly all of Malawi's rural poor. Fertilizer and seed will be distributed by the private sector, with payment and targeting relying on a voucher system. The program cost will be limited to MK 2.5 billion, compared with MK 600 million in domestically financed expenditures for the 2003/04 TIP it replaces.⁷ The net impact on the domestic financing would be about 1 percent of GDP.
- The government will purchase maize for social and commercial distribution when local supplies run low and it expects that the presence of available stocks in Malawi would limit the market volatility and price spikes seen in 2002. It also intends to sell the maize acquired for commercial purposes at prices sufficient to recover a significant part of expenses and to contain the cost to government to around ½ percent of GDP.
- The civil service pay system will be reformed in accordance with longstanding commitments. It is made more efficient and transparent by reducing the number of pay grades and consolidating wages and allowances. The fuel allowance, which in the past caused unbudgeted increases in compensation when world oil prices rose or the kwacha depreciated, will be eliminated. The approximately 600 civil servants who are on contract would fall under the new system if and when their contracts are renewed. The authorities indicated that they had used microsimulations to estimate the impact of new wage structure on the aggregate wage bill and will carry out a "dry run" at all payroll centers before the new system is implemented. However, the payroll may rise slightly above the MK 15 billion initially envisaged target (about 7 percent of GDP), reflecting a rise in compensation for parliamentarians. The authorities indicated that this was necessary to bring parliamentarian pay in line with others in the region; the added cost would be partially offset by the proposed taxation of previously untaxed benefits.
- Each of the nine ministries covered by the 2004 domestic arrears audit will be expected to clear at least a portion of their arrears within their budget allocation, based on a centrally monitored process, to ensure that all claims are verified and prioritized before payments are made. The budget framework sets aside MK 500 million (¼ percent of

⁷ The 2003/04 TIP also received direct donor funding that was not captured in the budget, and is estimated at about MK 1 billion.

GDP) for arrears. The remaining ministries would be audited once funding from a development partner is secured.

- The budget provides for the cost of ADMARC restructuring and a subsidy to cover the costs of the welfare-related outlays of ADMARC (MK 1.2 million, or just over ½ percent of GDP). Under the plan, parts of ADMARC will be commercialized. Social functions such as distributing food to the poor will continue to be subsidized.⁸

16. **The government will conduct a midyear review of its fiscal policies in January 2005.** The review will assess whether fiscal performance is on track to repay domestic debt in the second half of the year, and initiate further adjustment measures. The review will not be used to increase spending limits, except in the case of a donor-funded health initiative that is presently under consideration.

- **Savings opportunities.** The government is currently looking at areas, such as the management of vehicles and the use of utilities, where savings across ministries could be found.
- **Government pensions and gratuities.** The new civil service wage system is likely to result in higher government pension costs in the medium term because the previously paid allowances were not part of the base for pensions. The government will review ways to limit this impact.
- **Tax initiatives.** The government will review the feasibility of a ½ percentage point reduction in the surtax rate. It will also review personal income taxes.

17. **The authorities assured the mission that spending ceilings would be observed and that necessary programs and services would not be curtailed.** Spending allocations to ministries—excluding interest and the food security initiatives—would be reduced to 21 percent of GDP, from 22½ percent of GDP in 2003/04.⁹ Savings (in percent of GDP) are realized mainly in ministries' goods and services, arrears repayment, cost of elections, and in the domestically financed development budget, while some additional outlays are required for wages and salaries, communication equipment and ADMARC restructuring. The authorities indicated that additional savings might be possible, but they would be difficult to identify at this time because of the ongoing government restructuring. The staff indicated that the ceilings should be realistic and that pro-poor spending be protected. It recommended that spending be increased in a few areas even though this increased the domestic financing target initially set by the government.

⁸ ADMARC restructuring is part of the World Bank adjustment credit conditionality.

⁹ Wages and salaries, other current spending, and domestically financed developing spending.

18. **The authorities and mission agreed that controlling expenditures would be the key to successful budget implementation.** During June–July, the Ministry of Finance turned down requests for funding that exceeded budget limits. The authorities indicated that they would continue this practice and had already informed ministers that strict budget adherence was the policy of the new government. This change should help instill the discipline that has been lacking in recent years and promote efficiency. It will be supported by efforts to implement the 2003 Financial Management Act.

19. **The quarterly pattern of spending, tax revenue, and grants in the budget framework implies significant domestic borrowing during July–September.** The staff recommended that the authorities inform the public of the pattern as quickly as practical, to avoid adverse reactions in the treasury bill market. It urged the authorities to monitor maize and fertilizer purchases and donor disbursements carefully because these represented large flows and could distort domestic financing indicators.

B. Monetary and Exchange Rate Policies

20. **The goal of the government’s monetary policy is to lower inflation to around 10 percent by end-2005 and reduce it further to the 5–8 percent range in the medium term.** To meet this objective, the RBM will need to contain broad money growth and mop up the liquidity overhang that built up at the end of the 2003/04 financial year. Thus, during the July-September quarter, the program assumes that the RBM will sell RBM bills and treasury bills from its stock to limit the rise in net domestic assets (NDA). During October-December, the RBM would sell foreign exchange that it expects to receive from budget support for this purpose. The sale of foreign exchange would have the added benefit of easing interest rate pressures by reducing the supply of treasury and RBM bills offered to the public. In addition, to avoid exacerbating the liquidity overhang, the RBM has decided to postpone a planned decrease in the liquidity reserve requirement (LRR).

21. **The buildup of cash outside the banking system during April-June 2004 has added uncertainty to monetary operations.** Over this period, cash holdings increased 17 percent on a seasonally adjusted basis. RBM officials explained that some of this buildup could reflect an increase in demand for kwachas used in cross-border tobacco trade, or more generally an increase in kwacha use as a regional currency. The buildup could also reflect a temporary precautionary demand for cash during the election. In any case, they could not predict when the cash would reenter the banking system, but concurred that it would need to be mopped up as quickly as possible. They agreed to monitor deposits and broad money on a weekly basis so that they could act quickly. While the staff supported a gradual lowering of the Bank Rate to reduce borrowing cost of the government and enable cheaper credit to the private sector, it also recommended the RBM not to hesitate increasing the rate to meet program objectives.

C. External Sector and Program Financing

22. **The SMP assumes that budgetary support (about US\$115 million) will be disbursed from October onward.** Malawi's bilateral development partners assured the authorities that disbursements would take place after completion of the midyear review by the Common Approach to Budget Support (CABS) group, assuming good macroeconomic performance. The World Bank's structural adjustment credit (\$50 million) has been approved and would be disbursed in two tranches. African Development Bank is considering support that would be disbursed in 2005.

23. **The SMP also assumes that Malawi will continue to receive Heavily Indebted Poor Countries (HIPC) interim relief, except from the Fund and the AfDB.**¹⁰ Interim relief approved by the Fund and the AfDB has been exhausted, and fresh support will only be delivered once a new PRGF is in place. The authorities indicated that they will contact Paris Club creditors to identify their willingness to extend the interim period during the SMP. The Paris Club rescheduling agreement approved in January 2001 will expire in December 2004. However, if these creditors do not reach a consensus on extending the interim period beyond that date, nonrepayment of the reschedulable obligations would not be considered arrears under the SMP.

24. **In view of Malawi's high external debt, the authorities have committed to contract and guarantee external debt that is on concessional terms only.** However, the authorities informed the staff that the previous government purchased communications equipment for the Army in April 2004 that was to be financed commercially. Attempts to cancel the purchase without significant penalties were not successful (see MEFP Table 1).

D. Structural Measures

25. **Structural measures under the SMP will focus on public expenditure management.** Limiting structural conditionality to key measures for retaining control over government spending is in line with authorities' comments on the EPA.¹¹ Structural measures implemented in the near term should support the government's efforts to hold spending within budgeted amounts. The authorities would work to strengthen existing control mechanisms and implement the 2003 Public Finance Management and Audit Acts.

26. **The authorities will test the upgraded government payments clearing system at the RBM.** This system is designed to capture government payments and compare these against credit ceilings set for approximately 400 accounts in commercial banks. These data

¹⁰ For 2004 onward, Japanese debt relief will be recorded under debt relief. For 2002 and 2003, delivery of debt relief was through grants, which were used for the purchase of products from a positive list agreed between the two governments.

¹¹ The authorities' comments on the EPA will be summarized in the Article IV staff report.

can be reported daily and could help officials monitor expenditures on a cash basis. The system is also designed to ensure that cash ceilings do not exceed budgeted amounts.

E. Risks

27. **Despite the new government's stated commitment to macroeconomic stability, considerable risks remain.** The fiscal targets in the 2004/05 budget framework must be carried over into a full budget and approved by parliament. Then the government will need to break with past practices and implement the budget with steadfast adherence. The new government has already signaled a departure from above-budget spending, and it will have to work hard to sustain this effort. The impact of a full implementation of the civil service wage reform poses budget uncertainty because of the complexity involved. The authorities will also have to carefully monitor and mop up excess liquidity to meet the monetary targets and inflation objectives under the SMP, in part because of recent, unexplained changes in the demand for cash and the relationship between broad money growth and inflation.

F. Program Monitoring

28. The program will be monitored quarterly through the quantitative and structural benchmarks specified in Tables 1-2 of the MEFP (Appendix I). There will be one SMP review (testing end-December data) that will incorporate directors' views that might arise during the Article IV consultation and the EPA discussions. As in the past program, quantitative targets include ceilings on NDA of the RBM, ceilings on government domestic borrowing, and floors on the RBM's net international reserves. At the request of the authorities, government wages and salaries, and discretionary spending will also be monitored. These and other benchmarks are defined and explained in the technical memorandum of understanding (TMU, Appendix II).

IV. STAFF APPRAISAL

29. **Malawi made some progress during 2003 in reversing its poor economic performance.** Regrettably, fiscal slippages, especially in March–May 2004 and the long record of inadequate policy performance have damaged the economy through entrenched inflation expectations, high real interest rates, and depressed private sector investment. This legacy will be with Malawi for some time, and restoring the credibility of macroeconomic management is the best way to minimize its duration.

30. **Structural reform efforts are beginning to pay off.** The civil service wage system is about to undergo a major overhaul that would make it more transparent and improve incentives, especially in the professional grades. The phasing out of the fuel allowance as contractual employees fall under the new rules will also reduce the risk that budget ceilings will be exceeded. The new government is moving quickly to prosecute corrupt officials and the recent revisions to the Anti-Corruption Act should help.

31. **The SMP reflects the lessons learned from the EPA process and from the discussions held with the authorities on the EPA.** In particular, the authorities expressed concern on the scope and number of the structural measures included in past programs. The upcoming Article IV consultation will report on the implications of the main findings of the EPA for future Fund-supported programs.

32. **The 2004/05 budget framework, on which the SMP is based, balances the critical objective of restoring sound macroeconomic policies with pressing social needs.** The government has dedicated significant resources to food security by limiting increases in nonwage funding to ministries. Ministries will be expected to find savings and set priorities in order to operate within their allocations. The Ministry of Finance's refusal of requests for resources above the budget during June–July is an encouraging first step.

33. **The staff welcomes the government's plans for a midyear review of fiscal developments.** It will be important to evaluate budget execution and introduce any new savings measures that may have been developed. The staff believes that there is scope for savings across the government in common areas such as vehicles and utilities. It will also be important for the government to look closely at the cost and revenue implications of the civil service pay reform. However, the midyear review should not be used to raise spending, except that related to donor-funded health workers.

34. **The government's target of restricted domestic borrowing is appropriate in the current economic conditions.** The government had initially targeted some debt repayment during 2004/05. However, during the discussions, it became evident that Malawi's pressing social needs and current structure of government made this objective unrealistic. The staff agrees with the authorities' decision to include some domestic financing in the budget framework and postpone further spending cuts until efficiencies and other savings that do not jeopardize pro-poor spending can be identified.

35. **It is likely that significant borrowing will occur during July-September because of seasonal spending patterns, high debt interest payments, the cost of maize that must be purchased now, and little in donor support during the quarter.** The government's ability to limit domestic borrowing for the rest of the fiscal year will depend critically on support from Malawi's development partners. The program incorporates only disbursements that donors themselves have indicated are highly likely. The staff urges the government to use any unanticipated budget support for domestic debt reduction.

36. **The authorities need to implement the announced public expenditure management measures.** Malawi's systems of budget control have deteriorated in past years, but some improvements are on the way. The staff welcomes plans to test the information on government spending, now being collected with the RBM's payments clearing system, as well as the system's ability to reject cash ceiling allocations that are above the approved budget. Progress on the integrated financial management system is promising, but a realistic date for its full implementation is far off.

37. **The program faces a number of risks, most notably in the area of implementation of the fiscal program.** The steps now being taken by the government will clearly minimize these, but given Malawi's history of inadequate budget execution, it will be crucial that the new government makes clear that slippages will not be tolerated.

38. **The authorities' program seems to turn around a very difficult situation.** The fiscal program balances available resources against pressing social needs. The spending targets are tight but appear realistic and achievable. The staff will closely monitor program implementation. This program will help the authorities establish a track record that can restore credibility in macroeconomic policy implementation and provide a basis for moving to a PRGF arrangement in due course.

Table 1. Malawi: Selected Economic and Financial Indicators, 2001-05

	2001	2002	2003	2004		2005
	Act.	Prel.	Est.	Prog.	Proj.	Proj.
	(Percentage change, unless otherwise indicated)					
GDP and prices						
GDP at constant market prices	-4.1	1.9	4.4	5.0	3.9	4.2
Consumer prices (end of period)	22.1	7.6	9.8	5.5	20.0	10.0
Consumer prices (annual average)	27.2	14.9	9.6	7.3	14.9	15.0
GDP deflator	24.8	13.1	11.2	6.2	14.7	14.2
Interest rates (end of period) 1/	50.4	40.8	37.0	...	...	...
Nominal effective exchange rate (end period) 2/	39.3	-30.8	-18.0	...	...	...
Real effective exchange rate (end period) 2/	56.0	-35.3	-16.6	...	...	...
External sector						
Exports, f.o.b. (millions of U.S. dollars)	426.6	421.1	402.1	466.5	476.4	484.1
Imports, c.i.f. (millions of U.S. dollars)	584.5	726.8	629.6	626.4	703.0	693.3
Terms of trade	-0.3	-7.5	-7.9	3.0	-0.8	-1.0
Money and credit 3/						
Money and quasi money	21.2	25.2	29.3	10.0	25.5	14.8
Net foreign assets	-8.0	-55.4	21.5	24.6	1.8	8.0
Net domestic assets	29.2	80.6	7.8	-14.6	23.8	6.8
Credit to the government	29.4	45.1	11.3	-20.6	36.4	-3.6
Credit to the rest of the economy	-2.9	4.1	8.1	7.7	1.2	11.1
	(Percent of GDP, unless otherwise indicated)					
Central government 4/						
Revenue (excluding grants)	17.2	20.7	23.5	...	24.0	22.8
Expenditure	31.9	39.7	43.3	...	40.0	35.0
Underlying balance 5/	-2.8	-1.8	-0.9	...	1.2	4.0
Primary balance	-2.8	-5.0	3.7	...	4.7	6.3
Overall balance (cash basis, including grants)	-7.9	-12.1	-7.3	...	-4.3	-1.7
National saving						
Domestic saving	7.1	-1.0	2.4	5.6	1.9	2.4
Net factor income	2.7	-12.0	-5.0	0.0	-3.5	-2.3
Net factor income	-1.9	-2.4	-2.4	-2.3	-2.2	-1.9
Unrequited transfers	6.3	13.4	9.8	7.9	7.6	6.6
Net official transfers	5.7	12.6	9.0	7.3	6.9	5.9
Net private transfers	0.6	0.8	0.7	0.6	0.7	0.7
Gross investment						
Public	13.9	10.9	11.2	11.5	11.2	10.4
Private	10.4	8.0	9.7	9.7	9.3	7.9
Stock building	2.4	1.8	0.6	1.8	1.0	1.7
Stock building	1.1	1.0	0.9	0.0	0.9	0.8
External sector						
Exports, f.o.b.	25.0	22.6	23.6	25.7	26.7	25.1
Imports, c.i.f.	34.3	39.0	37.0	34.5	39.4	36.0
External current account (including official transfers)	-6.8	-11.9	-8.8	-5.9	-9.2	-8.1
External debt	160.5	148.8	166.3	160.7	160.7	151.7
Debt-service ratio 6/	20.0	20.3	23.5	21.4	21.1	21.0
Of which : interest payments 6/	6.3	6.2	6.6	5.6	5.4	5.2
	(In millions of U.S. dollars, unless otherwise indicated)					
Usabel gross official reserves 7/						
End-period stock	184.6	103.4	115.6	180.5	84.8	104.1
In months of imports of goods and nonfactor services 8/	2.7	1.7	1.8	2.8	1.3	1.6
External debt (disbursed and outstanding, end of period)	2,736	2,773	2,831	2,922	2,870	2,919
Memorandum items:						
GDP (in millions of kwacha)	123,080	142,928	165,751	184,100	197,370	234,889
Net domestic debt (in percent of GDP)						
Central government	7.4	18.1	23.2	...	27.3	22.5
Public sector 9/	10.7	15.4	19.9	...	21.8	18.1
Kwacha per U.S. dollar exchange rate (period average)	72.2	76.7	97.4	...	...	...
Per capita GDP (U.S. dollars)	162.0	173.5	155.3	...	...	...
Population (millions)	10.5	10.7	11.0	11.2	11.2	11.4

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

1/ Compounded three-month treasury bill interest rate.

2/ Positive value denotes appreciation of kwacha.

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

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

5/ Defined as overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize, plus foreign financed development expenditures.

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

7/ Excludes open letter of credit for 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.

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

9/ Private sector holdings of central government debt and RBM bills.

Table 2. Malawi: Central Government Operations, 2001/02-2004/05

	FY 2001/02	FY 2002/03	FY 2003/04		FY 2004/05
	Est.	Est. 1/	Prog.	Est.	Proj.
(In millions of MWI kwacha)					
Total revenue and grants	31,997	42,685	60,663	65,365	77,094
Revenue	22,853	32,009	37,992	42,754	51,881
Tax revenue	20,382	27,251	31,953	36,902	44,747
Taxes on income and profits	9,458	12,146	14,108	15,839	19,854
Taxes on goods and services	8,935	12,379	14,704	16,634	19,996
Taxes on international trade	2,423	3,136	3,607	5,082	5,897
Other (incl. refunds)	-435	-410	-466	-653	-1,001
Nontax revenue	2,471	4,758	4,339	5,852	7,135
Departmental receipts	1,141	1,614	2,420	2,237	2,440
Petroleum levy for NRA	1,113	1,222	1,391	1,285	1,482
Petroleum levy for safety nets	169	464	528	884	1,052
Sale receipts from maize (from NFRA)	...	591	0	1,351	2,160
Dividends	49	868	0	95	0
Revenue measures 2/	...	...	1,700	...	...
Grants	9,144	10,675	22,671	22,611	25,212
Program	2,544	1,220	8,177	4,580	5,418
Food security program	581	188	0	0	0
Partially tied grants	...	...	...	903	0
EDRC	...	...	...	1,090	0
Project	3,479	4,604	5,835	9,635	13,799
Financing of elections	...	...	480	653	0
HIPC Initiative debt relief	1,718	3,588	6,836	5,261	5,995
Japanese debt relief	821	1,075	1,344	490	0
Total expenditure and net lending	42,490	61,322	61,517	78,598	86,351
Total expenditure	42,490	61,260	61,517	78,598	86,351
Current expenditure	32,675	49,473	48,143	58,086	67,403
Wages and salaries	9,201	10,930	11,444	12,302	15,300
Interest payments	6,820	10,985	16,682	20,024	19,427
Domestic	5,242	8,871	13,985	17,253	16,863
Foreign	1,578	2,114	2,697	2,771	2,565
Other current expenditure	16,654	27,559	20,018	25,761	32,676
Goods and services	11,111	20,127	13,398	16,902	20,097
Of which: maize purchase	...	6,078	0	0	2,890
Subsidies and other current transfers	5,543	7,431	6,420	7,510	12,080
Expenditure for arrears	0	0	200	1,349	500
Expenditure measures 2/ 3/	...	0	-3,334	...	...
Development expenditure	9,816	11,787	16,708	20,512	18,947
Part I (foreign-financed)	7,761	9,521	14,175	17,231	16,804
Part II (domestically financed)	2,055	2,266	2,533	3,281	2,143
Overall balance (including grants)	-10,493	-18,637	-854	-13,233	-9,257
Total financing	9,148	18,099	3,085	14,938	9,257
Foreign (net)	-268	-730	8,424	425	5,063
Borrowing	4,282	4,917	15,287	7,185	11,215
Program	0	0	6,947	0	7,921
EDRC	0	0	0	1,386	514
Project	4,282	4,917	8,340	5,799	2,781
Amortization	-3,510	-5,448	-6,479	-7,577	-8,428
Special loans (net)	-332	-323	0	0	889
Japanese debt relief account	-708	125	-384	759	1,200
EU food security account	...	...	...	...	700
WB EDRC accounts (NY)	...	...	...	58	-514
Domestic (net)	9,416	18,829	-5,339	14,512	4,194
Statistical discrepancy	1,346	538	-2,231	-1,704	0
Memorandum items:					
Net domestic debt (T-bills are valued at cost)	13,518	32,654	27,315	47,104	51,298
Program support and HIPC Initiative debt relief	4,263	4,808	21,959	9,841	19,334
Primary balance (including grants)	-3,673	-7,652	15,828	6,790	10,170
Underlying balance 4/	-3,711	-2,781	5,100	-1,645	2,492

Table 2. Malawi: Central Government Operations, 2001/02-2004/05 (concluded)

	FY 2001/02	FY 2002/03	FY 2003/04		FY 2004/05
	Est.	Est. 1/	Prog.	Est.	Proj.
	(In percent of GDP)				
Total revenue and grants	24.1	27.7	34.7	36.0	35.7
Revenue	17.2	20.7	21.8	23.5	24.0
Tax revenue	15.3	17.7	18.3	20.3	20.7
Taxes on income and profits	7.1	7.9	8.1	8.7	9.2
Taxes on goods and services	6.7	8.0	8.4	9.2	9.3
Taxes on international trade	1.8	2.0	2.1	2.8	2.7
Other (incl. refunds)	-0.3	-0.3	-0.3	-0.4	-0.5
Nontax revenue	1.9	3.1	2.5	3.2	3.3
Departmental receipts	0.9	1.0	1.4	1.2	1.1
Petroleum levy for NRA	0.8	0.8	0.8	0.7	0.7
Petroleum levy for safety nets	0.1	0.3	0.3	0.5	0.5
Sale receipts from maize (from NFRA)	...	0.4	0.0	0.7	1.0
Dividends	0.0	0.6	0.0	0.1	0.0
Revenue measures 2/	...	...	1.0	...	...
Grants	6.9	6.9	13.0	12.5	11.7
Program	1.9	0.8	4.7	2.5	2.5
Food security program	0.4	0.1	0.0	0.0	0.0
Partially tied grants	...	...	...	0.5	0.0
EDRC	...	...	...	0.6	0.0
Project	2.6	3.0	3.3	5.3	6.4
Financing of Elections	...	...	0.3	0.4	0.0
HIPC Initiative debt relief	1.3	2.3	3.9	2.9	2.8
Japanese debt relief	0.6	0.7	0.8	0.3	0.0
Total expenditure and net lending	31.9	39.7	35.2	43.3	40.0
Total expenditure	31.9	39.7	35.2	43.3	40.0
Current expenditure	24.6	32.1	27.6	32.0	31.2
Wages and salaries	6.9	7.1	6.6	6.8	7.1
Interest payments	5.1	7.1	9.6	11.0	9.0
Domestic	3.9	5.7	8.0	9.5	7.8
Foreign	1.2	1.4	1.5	1.5	1.2
Other current expenditure	12.5	17.9	11.5	14.2	15.1
Goods and services	8.4	13.0	7.7	9.3	9.3
Of which: maize purchase	...	3.9	0.0	0.0	1.3
Subsidies and other current transfers	4.2	4.8	3.7	4.1	5.6
Expenditure for arrears	0.0	0.0	0.1	0.7	0.2
Expenditure measures 2/ 3/	...	0.0	-1.9	...	...
Development expenditure	7.4	7.6	9.6	11.3	8.8
Part I (foreign-financed)	5.8	6.2	8.1	9.5	7.8
Part II (domestically financed)	1.5	1.5	1.5	1.8	1.0
Net lending	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	-7.9	-12.1	-0.5	-7.3	-4.3
Total financing	6.9	11.7	1.8	8.2	4.3
Foreign (net)	-0.2	-0.5	4.8	0.2	2.3
Borrowing	3.2	3.2	8.8	4.0	5.2
Program	0.0	0.0	4.0	0.0	3.7
EDRC	...	0.0	0.0	0.8	0.2
Project	3.2	3.2	4.8	3.2	1.3
Amortization	-2.6	-3.5	-3.7	-4.2	-3.9
Special loans (net)	-0.2	-0.2	0.0	0.0	0.4
Japanese debt relief account	-0.5	0.1	-0.2	0.4	0.6
EU food security account	...	...	...	...	0.3
WB EDRC accounts (NY)	...	...	...	0.0	-0.2
Domestic (net)	7.1	12.2	-3.1	8.0	1.9
Statistical discrepancy	1.0	0.3	-1.3	-0.9	0.0
Memorandum items:					
Net domestic debt (T-bills valued at cost)	10.2	21.2	15.6	25.9	23.7
Overall balance (excluding grants)	-14.8	-19.0	-13.5	-19.7	-15.9
Primary balance (including grants)	-2.8	-5.0	9.1	3.7	4.7
Underlying balance 4/	-2.8	-1.8	2.9	-0.9	1.2
Program support plus HIPC Initiative debt relief	3.2	3.1	12.6	5.4	8.9
Nominal GDP	133,004	154,340	174,600	181,560	216,129

Sources: Malawian authorities; and Fund staff projections.

1/ Includes the 2002/03 maize operation (in contrast to presentation in EBS/03/133).

2/ For FY 2003/04 estimates, any measure taken is included in the appropriate category.

3/ For the 2003/04 program it was expected that these savings would result from a reduction of the travel budget, nonfilling of vacancies, a freeze on promotions, the postponement of new domestically financed development expenditure, and additional postponement of discretionary outlays.

4/ Defined as overall balance plus statistical discrepancy, less grants, less revenue from maize, plus total interest, plus expenditures for maize, plus foreign-financed development expenditures.

Table 3. Malawi: Central Government Operations, 2003/04-2004/05

	FY 2003/04					FY 2004/05				
	QI Est.	QII Est.	QIII Proj.	QIV Proj.	FY Proj.	QI Proj.	QII Proj.	QIII Proj.	QIV Proj.	FY Proj.
	(In millions of MWI kwacha)									
Total revenue and grants	14,352	18,112	19,078	13,823	65,365	15,489	20,820	20,481	20,304	77,094
Revenue	9,959	10,466	10,936	11,393	42,754	11,419	12,210	14,467	13,785	51,881
Tax revenue	8,631	8,703	9,258	10,309	36,902	10,323	10,688	11,390	12,345	44,747
Taxes on income and profits	3,616	3,545	4,121	4,557	15,839	4,374	5,025	4,928	5,528	19,854
Taxes on goods and services	3,899	4,160	4,076	4,499	16,634	4,775	4,600	5,180	5,442	19,996
Taxes on international trade	1,245	1,140	1,209	1,488	5,082	1,422	1,318	1,535	1,622	5,897
Other (incl. refunds)	-129	-141	-148	-234	-653	-248	-255	-252	-246	-1,001
Nontax revenue	1,327	1,762	1,678	1,084	5,852	1,096	1,521	3,077	1,440	7,135
Departmental receipts	568	577	546	546	2,237	463	537	634	806	2,440
Petroleum levy for NRA	330	371	308	277	1,285	371	371	371	371	1,482
Petroleum levy for safety nets	201	175	364	144	884	263	263	263	263	1,052
Sale receipts from maize (from NFRA)	229	640	460	22	1,351	0	351	1,809	0	2,160
Grants	4,393	7,647	8,142	2,429	22,611	4,070	8,610	6,014	6,519	25,212
Program	0	1,517	3,063	0	4,580	0	3,785	1,081	553	5,418
Partially tied grants	0	903	0	0	903	0	0	0	0	0
EDRC	790	147	152	0	1,090	0	0	0	0	0
Project	2,393	3,124	3,561	557	9,635	2,760	3,450	3,450	4,140	13,799
Financing of elections	0	87	27	539	653	0	0	0	0	0
HIPC Initiative debt relief	1,210	1,379	1,338	1,334	5,261	1,310	1,376	1,483	1,826	5,995
Japanese debt relief	0	490	0	0	490	0	0	0	0	0
Total expenditure	18,762	19,106	19,044	21,686	78,598	20,622	24,001	21,170	20,558	86,351
Current expenditure	14,523	12,416	13,063	18,084	58,086	16,698	19,215	16,482	15,008	67,403
Wages and salaries	2,961	2,976	3,132	3,233	12,302	3,400	3,900	3,936	4,064	15,300
Interest payments	5,287	4,580	5,199	4,957	20,024	5,518	3,995	5,144	4,771	19,427
Domestic	4,718	3,826	4,520	4,188	17,253	4,932	3,317	4,547	4,066	16,863
Foreign	570	753	679	769	2,771	586	678	596	704	2,565
Other current expenditure	6,275	4,860	4,732	9,894	25,761	7,780	11,321	7,402	6,173	32,676
Goods and services	4,075	2,967	2,894	6,965	16,902	5,176	6,322	4,233	4,365	20,097
Of which: maize purchases	0	0	0	0	0	1,390	1,500	0	0	2,890
Subsidies and other current transfers	1,782	1,889	1,711	2,128	7,510	2,604	4,832	3,002	1,642	12,080
Expenditure for arrears	418	4	127	800	1,349	0	167	167	167	500
Development expenditure	4,238	6,690	5,981	3,603	20,512	3,924	4,785	4,688	5,550	18,947
Part I (foreign-financed)	3,859	6,090	5,643	1,639	17,231	3,427	4,259	4,145	4,974	16,804
Part II (domestically financed)	380	600	338	1,963	3,281	498	527	543	576	2,143
Overall balance (including grants)	-4,410	-993	34	-7,864	-13,233	-5,133	-3,181	-689	-254	-9,257
Total financing	4,459	2,134	520	7,824	14,938	5,133	3,181	689	254	9,257
Foreign (net)	377	411	441	-804	425	-927	2,531	1,153	2,307	5,063
Borrowing	1,624	2,591	2,109	861	7,185	888	3,722	2,736	3,870	11,215
Program	0	0	0	0	0	0	2,844	2,041	3,035	7,921
EDRC	372	360	326	327	1,386	332	182	0	0	514
Project	1,252	2,231	1,783	534	5,799	556	695	695	834	2,781
Amortization	-1,535	-2,141	-2,091	-1,810	-7,577	-2,783	-1,920	-1,869	-1,856	-8,428
Special loans (net)	0	0	0	0	0	0	311	285	293	889
Japanese debt relief account	379	-252	375	257	759	600	600	0	0	1,200
EU food security account	...	...	...	...	...	700	0	0	0	700
WB EDRC accounts (NY)	-91	213	48	-112	58	-332	-182	0	0	-514
Domestic (net)	4,082	1,723	79	8,628	14,512	6,060	651	-464	-2,053	4,194
Statistical discrepancy	-49	-1,140	-554	39	-1,704	0	0	0	0	0
Memorandum items:										
Net domestic debt (T-bills valued at cost)	36,674	38,397	38,476	47,104	47,104	53,165	53,815	53,351	51,298	51,298
Program support and HIPC Initiative debt relief	1,210	2,896	4,402	1,334	9,841	1,310	8,005	4,605	5,414	19,334
Primary balance (including grants)	877	3,586	5,233	-2,906	6,790	385	814	4,455	4,517	10,170
Underlying balance	65	248	1,721	-3,679	-1,645	1,132	-2,389	777	2,972	2,492

Table 3. Malawi: Central Government Operations, 2003/04-2004/05 (concluded)

	FY 2003/04					FY 2004/05				
	QI Est.	QII Est.	QIII Proj.	QIV Proj.	FY Proj.	QI Proj.	QII Proj.	QIII Proj.	QIV Proj.	FY Proj.
	(In percent of GDP)									
Total revenue and grants	7.9	10.0	10.5	7.6	36.0	7.2	9.6	9.5	9.4	35.7
Revenue	5.5	5.8	6.0	6.3	23.5	5.3	5.6	6.7	6.4	24.0
Tax revenue	4.8	4.8	5.1	5.7	20.3	4.8	4.9	5.3	5.7	20.7
Taxes on income and profits	2.0	2.0	2.3	2.5	8.7	2.0	2.3	2.3	2.6	9.2
Taxes on goods and services	2.1	2.3	2.2	2.5	9.2	2.2	2.1	2.4	2.5	9.3
Taxes on international trade	0.7	0.6	0.7	0.8	2.8	0.7	0.6	0.7	0.8	2.7
Other (incl. refunds)	-0.1	-0.1	-0.1	-0.1	-0.4	-0.1	-0.1	-0.1	-0.1	-0.5
Nontax revenue	0.7	1.0	0.9	0.6	3.2	0.5	0.7	1.4	0.7	3.3
Departmental receipts	0.3	0.3	0.3	0.3	1.2	0.2	0.2	0.3	0.4	1.1
Petroleum levy for NRA	0.2	0.2	0.2	0.2	0.7	0.2	0.2	0.2	0.2	0.7
Petroleum levy for safety nets	0.1	0.1	0.2	0.1	0.5	0.1	0.1	0.1	0.1	0.5
Sale receipts from maize (from NFRA)	0.1	0.4	0.3	0.0	0.7	0.0	0.2	0.8	0.0	1.0
Grants	2.4	4.2	4.5	1.3	12.5	1.9	4.0	2.8	3.0	11.7
Program	0.0	0.8	1.7	0.0	2.5	0.0	1.8	0.5	0.3	2.5
Partially tied grants	0.0	0.5	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0
EDRC	0.4	0.1	0.1	0.0	0.6	0.0	0.0	0.0	0.0	0.0
Project	1.3	1.7	2.0	0.3	5.3	1.3	1.6	1.6	1.9	6.4
Financing of elections	0.0	0.0	0.0	0.3	0.4	0.0	0.0	0.0	0.0	0.0
HIPC Initiative debt relief	0.7	0.8	0.7	0.7	2.9	0.6	0.6	0.7	0.8	2.8
Japanese debt relief	0.0	0.3	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Total expenditure	10.3	10.5	10.5	11.9	43.3	9.5	11.1	9.8	9.5	40.0
Current expenditure	8.0	6.8	7.2	10.0	32.0	7.7	8.9	7.6	6.9	31.2
Wages and salaries	1.6	1.6	1.7	1.8	6.8	1.6	1.8	1.8	1.9	7.1
Interest payments	2.9	2.5	2.9	2.7	11.0	2.6	1.8	2.4	2.2	9.0
Domestic	2.6	2.1	2.5	2.3	9.5	2.3	1.5	2.1	1.9	7.8
Foreign	0.3	0.4	0.4	0.4	1.5	0.3	0.3	0.3	0.3	1.2
Other current expenditure	3.5	2.7	2.6	5.4	14.2	3.6	5.2	3.4	2.9	15.1
Goods and services	2.2	1.6	1.6	3.8	9.3	2.4	2.9	2.0	2.0	9.3
<i>Of which: maize purchases</i>	0.0	0.0	0.0	0.0	0.0	0.6	0.7	0.0	0.0	1.3
Subsidies and other current transfers	1.0	1.0	0.9	1.2	4.1	1.2	2.2	1.4	0.8	5.6
Expenditure for arrears	0.2	0.0	0.1	0.4	0.7	0.0	0.1	0.1	0.1	0.2
Development expenditure	2.3	3.7	3.3	2.0	11.3	1.8	2.2	2.2	2.6	8.8
Part I (foreign-financed)	2.1	3.4	3.1	0.9	9.5	1.6	2.0	1.9	2.3	7.8
Part II (domestically financed)	0.2	0.3	0.2	1.1	1.8	0.2	0.2	0.3	0.3	1.0
Overall balance (including grants)	-2.4	-0.5	0.0	-4.3	-7.3	-2.4	-1.5	-0.3	-0.1	-4.3
Total financing	2.5	1.2	0.3	4.3	8.2	2.4	1.5	0.3	0.1	4.3
Foreign (net)	0.2	0.2	0.2	-0.4	0.2	-0.4	1.2	0.5	1.1	2.3
Borrowing	0.9	1.4	1.2	0.5	4.0	0.4	1.7	1.3	1.8	5.2
Program	0.0	0.0	0.0	0.0	0.0	0.0	1.3	0.9	1.4	3.7
EDRC	0.2	0.2	0.2	0.2	0.8	0.2	0.1	0.0	0.0	0.2
Project	0.7	1.2	1.0	0.3	3.2	0.3	0.3	0.3	0.4	1.3
Amortization	-0.8	-1.2	-1.2	-1.0	-4.2	-1.3	-0.9	-0.9	-0.9	-3.9
Special loans (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.4
Japanese debt relief account	0.2	-0.1	0.2	0.1	0.4	0.3	0.3	0.0	0.0	0.6
EU food security account	...	...	...	...	...	0.3	0.0	0.0	0.0	0.3
WB EDRC accounts (NY)	-0.1	0.1	0.0	-0.1	0.0	-0.2	-0.1	0.0	0.0	-0.2
Domestic (net)	2.2	0.9	0.0	4.8	8.0	2.8	0.3	-0.2	-0.9	1.9
Statistical discrepancy	0.0	-0.6	-0.3	0.0	-0.9	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Net domestic debt (T-bills valued at cost)	20.2	21.1	21.2	25.9	25.9	24.6	24.9	24.7	23.7	23.7
Program support plus HIPC Initiative debt relief	0.7	1.6	2.4	0.7	5.4	0.6	3.7	2.1	2.5	8.9
Overall balance (excluding grants)	-4.8	-4.8	-4.5	-5.7	-19.7	-4.3	-5.5	-3.1	-3.1	-15.9
Primary balance (including grants)	0.5	2.0	2.9	-1.6	3.7	0.2	0.4	2.1	2.1	4.7
Underlying balance	0.0	0.1	0.9	-2.0	-0.9	0.5	-1.1	0.4	1.4	1.2
Nominal GDP	181,560	181,560	181,560	181,560	181,560	216,129	216,129	216,129	216,129	216,129

Sources: Malawian authorities; and Fund staff projections.

Table 4. Malawi : Monetary Authorities' Balance Sheet, 2002-05
(In millions of Malawi kwacha, unless otherwise indicated)

	2002				2003				2004			2005		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
									Proj.	Act.	Proj.	Proj.	Proj.	Proj.
Reserve money 1/	7,245	8,877	9,879	10,682	8,717	9,836	12,846	13,743	12,058	12,393	18,800	17,193	14,864	18,674
Currency outside banks	4,306	6,067	6,226	5,964	5,558	7,827	8,160	7,838	7,211	...	...	...	...	...
Cash in vault	509	683	852	1,101	909	1,079	1,173	1,449	1,382	...	...	...	...	...
Commercial bank deposits with RBM	2,430	2,128	2,801	3,617	2,250	930	3,512	4,455	3,465	...	...	...	...	...
Net foreign assets (NFA)	3,998	7,194	1,531	-3,558	-4,467	-330	-1,210	1,455	698	7,852	-8	-322	-1,472	3,685
NFA (in millions of U.S. dollars)	50.9	93.9	19.0	-40.8	-48.8	-3.7	-11.2	13.4	6.4	87.3	-0.1	-11.7	-3.0	33.8
Gross foreign assets	124.9	167.1	114.0	103.4	85.0	89.8	81.2	115.6	106.3	185.5	93.6	84.8	73.1	114.1
Foreign liabilities	-74.0	-73.3	-95.0	-144.2	-133.7	-93.4	-92.4	-102.2	-99.9	-98.2	-93.7	-87.8	-86.6	-80.2
Net domestic assets	3,247	1,683	8,348	14,239	13,184	10,166	14,056	12,288	11,360	4,541	18,731	17,515	16,336	14,988
Credit to government (net)	4,313	1,386	4,661	9,666	11,334	10,613	10,487	8,245	9,323	7,986	17,215	20,466	20,002	17,949
Credit to statutory bodies (net)	314	314	314	0	0	0	0	0	0	0	0	0	0	0
Credit to domestic banks	3	6	3	3	118	3	138	3	3	4	2	3	3	3
Other items (net)	-1,383	-22	3,370	4,570	1,731	-450	3,431	4,039	2,034	-3,448	1,514	-2,954	-3,669	-2,964
Revaluation accounts	198	254	451	-4	170	-337	-119	0	10	-3,513	0	0	0	0
Open market operations	-5,908	-6,621	-7,201	-5,850	-7,018	-9,212	-4,566	-2,914	-5,233	-11,379	-5,199	-6,816	-10,070	-8,991
Encumbered reserves	1,306	2,001	6,513	5,105	2,998	1,784	1,989	759	761	1,744	305	1,013	1,013	1,013
Others	3,021	4,344	3,608	5,319	5,581	7,315	6,127	6,194	6,495	9,700	6,408	5,669	5,388	5,014
Memorandum items:														
Seasonally adjusted reserve money	8,803	8,703	9,406	10,542	10,619	9,595	12,236	13,496	14,707	...	18,191	17,908	16,884	18,144
Quarterly change	8.3	-1.1	8.1	12.1	0.7	-9.6	27.5	10.3	9.0	...	23.7	-1.6	-5.7	7.4
Annual change	20.2	13.3	16.3	29.7	20.6	10.2	30.1	28.0	38.5	...	89.6	46.4	25.1	23.3
Seasonally adjusted currency outside banks	5,093	5,464	5,814	6,362	6,573	7,049	7,620	8,362	8,529	...	9,972	...	...	...
Quarterly change	17.4	7.3	6.4	9.4	3.3	7.3	8.1	9.7	2.0	...	16.9	...	...	...
Annual change	12.7	14.5	33.3	46.7	29.1	29.0	31.1	31.4	29.8	...	41.5	...	...	...
Money multiplier	2.77	2.70	2.57	2.55	3.06	3.20	2.64	2.56	2.97	...	2.28	2.34	2.57	2.68
Seasonally adjusted	2.53	2.62	2.64	2.58	2.80	3.11	2.70	2.59	2.72	...	2.22	2.40	2.60	2.60
Net domestic debt	12,505	13,518	17,643	25,821	28,734	32,654	36,674	38,397	38,476	...	47,104	53,165	53,351	51,298
Central government	14,100	18,753	20,183	22,005	24,417	31,253	30,753	33,065	34,386	...	35,088	40,165	42,985	42,340
Public sector 2/	10,069	13,724	14,323	14,703	16,134	21,248	20,345	22,277	23,973	...	25,119	28,432	30,006	28,591
Net sales	1,115	4,653	1,429	1,823	2,412	6,836	-500	2,312	1,321	...	702	5,077	2,820	-1,080
Annual change	2,482	5,644	7,197	7,905	5,664	11,071	8,748	8,648	3,133	...	4,335	9,919	9,034	7,252

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

1/ End-March 2003 and end-June 2003 reserve money figures were low due to RBM intervention just prior to the end of the month.

2/ Private sector holdings of central government debt and RBM bills.

Table 5. Malawi : Monetary Survey, 2002-05 1/
(In millions of Malawi kwacha, unless otherwise indicated)

	2002				2003				2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Money and quasi-money	20,058	23,983	25,402	27,210	26,641	31,521	33,869	35,183	35,776	42,741	44,044	44,164	42,218	49,998		
Money	9,712	12,791	13,213	13,440	13,421	17,154	18,008	17,464	17,012	23,503	...	...	...	...
Quasi-money	10,346	11,192	12,189	13,770	13,220	14,367	15,861	17,718	18,764	19,238	...	...	...	...
<i>Of which:</i> foreign currency deposits	3,094	3,560	3,655	4,505	4,549	4,772	5,886	5,362	7,234	7,719	...	...	...	...
Net foreign assets (NFA)	7,208	11,391	5,222	-380	-489	3,883	3,322	5,466	6,128	6,585	4,911	6,082	4,496	10,960		
NFA (in millions of U.S. dollars)	93.8	148.6	65.0	-4.4	-5.3	43.2	30.7	50.4	56.3	60.5	45.1	55.8	41.3	100.6		
Gross foreign assets	180.0	237.1	171.3	152.7	137.8	148.3	140.8	167.3	169.7	174.7	156.4	163.9	148.2	201.2		
Foreign liabilities	-86.2	-88.5	-106.3	-157.0	-143.1	-105.1	-110.1	-117.0	-113.4	-114.2	-111.3	-108.1	-106.9	-100.5		
Monetary authorities	3,998	7,194	1,531	-3,558	-4,467	-330	-1,210	1,455	698	-8	-1,275	-322	-1,472	3,685		
NFA of the monetary authorities (in millions of U.S. dollars)	50.9	93.9	19.0	-40.8	-48.8	-3.7	-11.2	13.4	6.4	-0.1	-11.7	-3.0	-13.5	33.8		
Gross foreign assets	124.9	167.1	114.0	103.4	85.0	89.8	81.2	115.6	106.3	93.6	81.3	84.8	73.1	114.1		
Foreign liabilities	-74.0	-73.3	-95.0	-144.2	-133.7	-93.4	-92.4	-102.2	-99.9	-93.7	-93.0	-87.8	-86.6	-80.2		
Commercial banks	3,210	4,197	3,691	3,178	3,978	4,213	4,532	4,011	5,429	6,593	6,186	6,404	5,968	7,275		
NFA of the commercial banks (in millions of U.S. dollars)	42.9	54.8	46.0	36.5	43.4	46.9	41.9	36.9	49.8	60.5	56.8	58.8	54.8	66.8		
Gross foreign assets	55.1	70.0	57.3	49.3	52.8	58.5	59.6	51.7	63.4	81.1	75.1	79.1	75.1	87.1		
Foreign liabilities	-12.2	-15.2	-11.3	-12.8	-9.4	-11.7	-17.7	-14.8	-13.6	-20.6	-18.3	-20.3	-20.3	-20.3		
Net domestic assets (NDA)	12,851	12,592	20,180	27,590	27,130	27,638	30,547	29,717	29,649	36,156	39,133	38,083	37,722	39,038		
Credit to government (net)	7,372	5,520	9,218	15,626	17,995	19,458	20,410	18,694	19,068	27,025	30,867	31,517	31,053	29,000		
Credit to statutory bodies (net)	367	482	152	-120	-588	-698	-266	-352	-222	-720	-752	-786	-814	-842		
Credit to private sector	6,998	6,838	6,916	7,363	7,541	9,665	8,888	9,809	9,544	10,459	10,362	10,660	11,923	13,428		
Other items (net)	-1,886	-247	3,894	4,721	2,182	-787	1,515	1,566	1,259	-608	-1,343	-3,308	-4,440	-2,548		
RBM's revaluation accounts	198	254	451	-4	170	-337	-119	0	10	0	0	0	0	0		
Open market operations	-4,961	-5,746	-5,991	-4,508	-5,395	-8,056	-4,080	-2,574	-4,565	-5,039	-6,134	-7,708	-8,560	-6,293		
Encumbered reserves	1,306	2,001	6,513	5,105	2,998	1,784	1,989	759	761	305	1,013	1,013	1,013	1,013		
Others	1,571	3,243	2,921	4,128	4,409	5,822	3,725	3,381	5,053	4,126	3,778	3,387	3,107	2,732		
Memorandum items:																
Seasonally adjusted broad money	21,925	22,911	24,608	27,471	29,120	30,112	32,811	35,520	39,106	40,830	42,667	44,587	46,148	47,763		
Quarterly change	0.0	4.5	7.4	11.6	6.0	3.4	9.0	8.3	10.1	4.4	4.5	4.5	3.5	3.5		
Annual change	18.3	8.6	21.1	25.2	32.8	31.4	33.3	29.3	34.3	35.6	30.0	25.5	18.0	17.0		
Seasonally adjusted credit to private sector	7,027	6,845	7,061	7,212	7,552	9,647	9,072	9,626	9,549	10,437	10,152	10,863	11,916	13,458		
Quarterly change	11.3	-2.6	3.1	2.2	4.7	27.7	-6.0	6.1	-0.8	9.3	-2.7	7.0	9.7	12.9		
Annual change	28.3	29.1	14.9	14.3	7.5	40.9	28.5	33.5	26.4	8.2	11.9	12.9	24.8	28.9		
Velocity of money (annual GDP divided by average broad money)	6.0	5.9	6.1	5.9	5.8	5.6	5.4	5.2	4.8	4.5	4.5	4.7	4.7	5.2		

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

1/ Covers four commercial banks (prior tables cover only two banks). Starting in June 2003, data include merger between Stanbic Bank (formerly Commercial Bank of Malawi, CBM) and CBM Financial Services (formerly a nonbank financial institution).

Table 6. Malawi: Balance of Payments, 2001-07
(In millions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004		2005	2006	2007
	Act.	Prel.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
Current account balance (including grants)	-116.5	-221.2	-149.8	-107.7	-165.1	-155.0	-163.1	-187.0
Trade balance	-157.9	-305.7	-227.5	-159.9	-226.6	-209.2	-201.2	-198.8
Exports	426.6	421.1	402.1	466.5	476.4	484.1	499.4	516.5
Imports	-584.5	-726.8	-629.6	-626.4	-703.0	-693.3	-700.6	-715.4
Services balance	-66.3	-165.1	-88.7	-90.8	-74.8	-72.2	-78.1	-79.8
Interest public sector (net)	-17.8	-20.2	-25.5	-24.3	-24.1	-20.2	-22.9	-21.4
Receipts	8.7	2.5	1.5	4.9	1.3	3.5	5.3	5.4
Payments (amounts due before debt relief)	-26.5	-22.7	-27.0	-29.2	-25.4	-23.7	-28.2	-26.8
Other factor payments (net)	-15.3	-24.5	-15.1	-17.4	-15.7	-16.4	-17.0	-17.7
Nonfactor (net)	-33.1	-120.4	-48.1	-49.2	-35.0	-35.7	-38.2	-40.7
Unrequited transfers (net)	107.7	249.6	166.4	143.0	136.3	126.4	116.2	91.7
Private (net)	9.9	14.3	12.4	10.5	12.7	12.9	13.2	13.4
Receipts	21.8	27.7	27.7	23.0	28.2	28.7	29.3	29.9
Payments	-11.8	-13.4	-15.3	-12.5	-15.5	-15.8	-16.1	-16.4
Official (net)	97.7	235.3	154.0	132.5	123.7	113.5	103.1	78.3
Receipts	98.3	235.3	154.0	133.1	123.7	113.5	103.1	78.3
Balance of payments assistance	51.0	12.8	41.7	73.2	62.6	58.5	48.1	28.3
Japan HIPC Initiative 1/	0.0	11.0	16.6	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
Project related	47.3	76.1	77.7	59.9	61.0	55.0	55.0	50.0
Drought related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Food Security (not yet received in RBM)	0.0	0.0	18.0		0.0	0.0	0.0	0.0
Payments	-0.6	0.0	0.0	-0.6	0.0	0.0	0.0	0.0
Capital account balance (incl. errors and omissions)	85.0	64.7	102.0	102.6	130.7	121.0	77.8	75.2
Medium- and long-term flows	59.8	23.8	29.5	56.9	56.8	64.6	40.0	40.5
Disbursements	127.0	81.0	115.3	127.4	131.6	133.6	118.4	118.4
Balance of payments support	55.0	0.0	18.4	28.8	35.6	42.6	27.4	27.4
Project support	72.0	81.0	96.9	98.6	86.0	91.0	91.0	91.0
Other medium-term loans					10.0			
Other investment assets	0.0	0.0	-17.2	0.0	2.9	0.0	0.0	0.0
Amortization (amounts due before debt relief)	-67.2	-57.2	-68.6	-70.5	-77.6	-69.0	-78.3	-77.8
Foreign direct investment and other inflows	28.0	37.6	43.2	45.8	44.1	30.9	32.7	34.7
Short-term capital and errors and omissions	-2.8	3.3	29.3	0.0	29.8	25.5	5.0	0.0
Overall balance	-31.5	-156.5	-47.7	-5.1	-34.4	-34.0	-85.3	-111.8
Financing (- increase in reserves)	31.5	156.5	47.8	5.1	34.4	24.1	21.5	27.4
Central bank	11.8	111.4	7.0	-64.8	7.2	-37.3	-29.0	-18.8
Gross reserves (- increase)	40.7	40.8	41.4	-63.0	29.2	-19.3	1.8	-9.3
Liabilities	-28.9	70.6	-34.4	-1.8	-22.0	-18.0	-30.7	-9.5
Of which: IMF (net)	-7.8	15.6	-1.0	-1.9	-14.4	-19.1	-31.9	-9.6
Purchases/drawings	0.0	23.0	9.3	35.1	0.0	0.0	0.0	0.0
Repurchases/repayments	-7.8	-7.4	-10.2	-36.9	-14.4	-19.1	-31.9	-9.6
Bridge loan	0.0	50.0	-50.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	-7.7	14.5	-6.7	-8.0	-21.9	5.0	-9.0	-10.5
Debt relief	27.4	30.6	47.5	77.9	49.1	56.4	59.4	56.7
Residual financing gap (+ underfinanced)	0.0	0.0	0.0	0.0	0.0	9.9	63.8	84.4
Memorandum items:								
Gross official reserves								
In millions of U.S. dollars	202.9	162.1	120.7	199.5	91.5	110.8	109.0	118.3
In months of imports 2/	3.0	2.7	1.8	3.1	1.4	1.7	1.6	1.7
In months of imports 3/	3.6	2.4	2.0	3.3	1.4	1.7	1.7	1.8
Usable gross official reserves 4/								
In millions of U.S. dollars	184.6	103.4	115.6	180.5	84.8	104.1	102.3	111.6
In months of imports 2/	2.7	1.7	1.8	2.8	1.3	1.6	1.5	1.6
In months of imports 3/	3.3	1.5	1.9	3.0	1.3	1.6	1.5	1.7
Current account balance (percent of GDP)								
Excluding official transfers	-12.6	-24.5	-17.8	-13.3	-16.2	-13.9	-13.3	-12.6
Including official transfers	-6.8	-11.9	-8.8	-6.0	-9.2	-8.1	-8.1	-8.9
Export value growth (in percent)	6.2	-1.3	-4.5	7.5	18.5	1.6	3.2	3.4
Import value growth, excluding maize (in percent)	2.3	1.1	6.3	0.4	11.7	-1.4	1.1	2.1

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

1/ For 2002-03, relief was provided through grants in Yens. From 2004 onward, debt will be written off and recorded under debt relief.

2/ In months of following year's imports of goods and nonfactor services.

3/ In months of current year's imports of goods and nonfactor services.

4/ Excludes open letter of credit for 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.

September 8, 2004

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

Dear Mr. de Rato:

1. On December 21, 2000, the Executive Board of the International Monetary Fund (IMF) approved a three-year arrangement for Malawi under the Poverty Reduction and Growth Facility (PRGF). The implementation of our poverty reduction and growth strategy supported by the arrangement has been slower than envisaged owing to slippages in macroeconomic policies. Because this arrangement expires in December 2004, we have decided to request a staff-monitored program in order to establish a performance track record. We would like to move into a new PRGF arrangement as soon as possible so that we can continue to restore sound financial policies and make progress with our structural reform program.
2. The government is committed to reestablishing macroeconomic stability. In the two months since the government was formed, we have stopped extrabudgetary expenditures that contributed significantly to excess spending in the past. Our policy of strict adherence to budget limits will be made easier because our new budget framework identifies all foreseeable expenditures. In addition, the Reserve Bank of Malawi has renewed its efforts to contain last year's monetary expansion.
3. The attached memorandum of economic and financial policies (MEFP) describes Malawi's economic and financial policies for 2004/05 (July-June). The program is derived from the Malawi Poverty Reduction Strategy Paper (MPRSP) and builds on the policy measures outlined in our letter of intent of September 19, 2003. We aim to establish a track record of strong performance by observing the quantitative and structural benchmarks set out in the attached memorandum. We request that the staff monitor our performance quarterly.
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/
Dr. Ellias E. Ngalande
Governor
Reserve Bank of Malawi

/s/
Goodall Gondwe
Minister of Finance

Attachments

MALAWI

**Memorandum of Economic and Financial Policies
of the Government of Malawi**

September 8, 2004

I. INTRODUCTION

1. This memorandum of economic and financial policies (MEFP) outlines the government of Malawi's economic policies for the period July 2004 – June 2005, the 2004/05 financial year. It updates our policy statement of June 28, 2004.
2. Malawi's overriding goals of economic policy are high and sustainable economic growth that will spur poverty reduction and the achievement of the Millennium Development Goals. We must first, however, face the immediate problems posed by rising government domestic debt and high interest rates that threaten macroeconomic stability. Without a sound and stable financial environment, the government's domestic debt service obligations will continue to deter investment as well as crowd out expenditures for the transformation of the economy and pressing social needs such as education and health. Private sector investment has been dampened by very high interest rates. Moreover, financing government deficits by printing money will push up inflation and erode the savings and buying power of the poor. Thus, our near-term economic program emphasizes the containment of nonessential spending and efficient revenue collection. This will help stabilize government finances and pave the way for future economic successes.
3. Although much was accomplished during 2003/04, several targets under the Fund-supported economic program were not achieved. The new government has therefore decided on a fresh start and has asked IMF staff to establish a staff-monitored program (SMP). This arrangement will help us adhere to sound macroeconomic policies and restart financial support from the IMF.

II. ECONOMIC BACKGROUND

4. Economic growth increased to 4½ percent in 2003, up from 2 percent in 2002, but regrettably below that needed for significant poverty reduction. The average rate of inflation continued to decline in 2003, marking the fourth year of progress in this area, and reinforcing a key element of macroeconomic stability. However, nonfood inflation picked up during the year, reflecting the depreciation of the kwacha in July-August 2003 and rapid growth in the monetary aggregates. Real interest rates remained high, adversely affecting private sector development.
5. Preliminary indicators present a mixed picture for the first half of 2004. Our maize crop was lower than a year ago due to adverse weather conditions, but tobacco production

has increased, in part because of new opportunities for small scale-farmers such as contract farming. On balance, we now expect economic growth in the neighborhood of 4 percent, still well below our medium-term target. Nonfood inflation remained high, while locally produced food prices were relatively stable through June.

6. The Reserve Bank of Malawi (RBM) reduced its Bank Rate in three steps from 45 percent in late 2003 to 25 percent in June 2004. Yields on treasury bills and key commercial bank lending rates fell by similar amounts. The kwacha–U.S. dollar exchange rate remained stable over the period.

A. Review of the 2003/04 Program with the IMF

7. Since November of last year, we have complied with some, but not all, of the conditions set out in our Fund-supported program. We fell behind schedule on structural measures at the end of 2003, but by mid-March 2004 we had regained momentum with the strengthening of the Anti-Corruption Act, initiation of the domestic arrears audit, and preparations for streamlining the civil service compensation system. These efforts are paying off. In particular, we are on track to consolidate civil service wages and allowances and launch the new civil service pay scales in October 2004. The domestic arrears audit of nine ministries is nearing completion and will be extended to cover the rest of the government. The report on grain purchases in 2002 conducted by the Anti-Corruption Bureau has been forwarded to the Director of Public Prosecutions.

8. Our budget objectives were missed in December 2003, largely because of delays in donor assistance and higher domestic interest costs, but also because of some unplanned demands from the Office of the President, Foreign Affairs, security-related ministries, and special activities. As a result of these pressure points, parliament approved a supplementary budget in March 2004 that aimed to contain government borrowing and hold down the deficit. We revised our program targets with the IMF for end-March and end-June accordingly. Unfortunately, spending pressures again developed in March-May, and we exceeded targets for the government's deficit and domestic money creation. In consequence of these developments, the level of government debt rose sharply over the course of the fiscal year despite strong revenue performance.

9. Monetary developments were mostly driven by the budget deficit and its financing. By end-June 2004, government debt had reached MK 55 billion kwacha, from MK 38 billion a year before (gross debt valued at cost). RBM credit to the government had increased by more than 60 percent from June 2003, causing a very sharp rise in the monetary base. The RBM's ability to mop up this liquidity injection, however, was hampered by low levels of foreign exchange reserves and the rise in currency outside of the banking system. The RBM began to mop up excess liquidity in July 2004 by selling treasury and RBM bills.

10. During the 2004 Article IV consultations, we had the opportunity to discuss Malawi's Fund-supported economic programs over the past ten years. This is a very important exercise for both Malawi and the IMF. We draw two important lessons. First, continued engagement

with the IMF will be critical for our economic success as we share the view that macroeconomic stability is the foundation of Malawi's economic future. Second, past Fund-supported programs incorporated too many structural conditions. Some of these conditions were not directly controlled by the government and, in hindsight, should not have been included in the program.

III. THE ECONOMIC PROGRAM THROUGH JUNE 2005

11. A sound, sustainable macroeconomic framework is the cornerstone of our future economic success and, with food security, is an overriding priority. The government of President wa Mutharika is therefore committed to restoring budget discipline and reining in monetary growth. This strategy will help reduce inflationary pressures and lower interest rates. Moreover, we note that the financial targets we established for end-June 2004 were observed.

A. Fiscal Policy

12. Our fiscal policy objective over the coming year is to eliminate domestic borrowing by the government. This will be achieved in three steps. *First*, parliament approved a provisional warrant budget in early July that allows ministries to spend one-quarter of the authorized level for 2003/04 during the period July-September. *Second*, a budget for the full 2004/05 fiscal year; in line with SMP targets, will be presented to parliament in September. *Third*, we will revisit our performance in the January 2005 midyear budget review. We will use this opportunity to quantify the savings anticipated from recent policy initiatives. We will also look at specific measures to help us achieve the targets outlined in this paper. Some of those are outlined below.

The 2004/05 budget framework

13. As of the date of this memorandum, we are completing our budget framework for 2004/05. We are making every effort to make the budget comprehensive by including all foreseeable spending needs. This will help us avoid the underfunding that contributed to spending pressures in the past. Discussions at the ministry level proceeded during August, and we hope to begin debate in parliament in early September.

14. Our budget framework projects domestic borrowing of about 2 percent of GDP; significant borrowing will occur during the first quarter of the year. The projected borrowing in this period reflects the legacy of high interest rates and debt levels carrying over from last year and the conservative assumption that donor flows will only pick up beginning in October. In addition, we will purchase maize and fertilizer during the August-October period. We would begin to pay down our debt in 2005.

15. The proposed budgetary framework for FY2004/05 implies substantial savings relative to the last fiscal year. The funding for core recurrent expenditures, which is defined as current expenditures less debt service, maize, fertilizer, and expenses for the 2004 election, will increase by 6 percent, compared with an increase in nominal GDP of about 20

percent. We intend to focus our development budget on ongoing projects before beginning new ones. This will result in a MK 1 billion savings, compared with last year. In this year's budget there is a shift towards expenditure on medicine and food security, both priority areas. Specific savings measures include

- Travel budget. The travel budget will be reduced by 25 percent.
 - Eliminating the special activities vote. Beginning with the 2004/05 budget, any special expenditures will be met through the benefiting ministry's budget allocation.
 - Moving the presidency. The presidency has been moved to Lilongwe, producing saving on mirror ministerial offices in Blantyre and on travel.

16. We plan to implement several high priority policies. The fertilizer and maize programs reflect the importance of food security, while civil service reform, repayment of arrears, and ADMARC restructuring will contribute to fiscal sustainability in the medium term.

- A targeted seed and fertilizer program to enlarge TIP (targeted input program). We plan to issue vouchers toward the purchase of seed and fertilizer to about two million households living under the poverty line. The cost of the program will be held to MK 2.5 billion.
- Maize purchases. The strategic grain reserve (SGR) will be replenished as planned, in part funded by donors. The SGR will be distributed, if necessary, by the WFP and other organizations. In addition, the government will purchase maize for commercial distribution during the hungry season as a means of ensuring orderly maize markets and avoiding price spikes that could otherwise result from this year's low maize harvest. We will spend no more than MK 1.5 billion for the maize, and if this maize is sold for MK 17 per kilogram, the net cost to the government's budget will be limited to about MK 800 million, depending on the difference between the government's purchase and sales price.
- Civil service pay reform. We will introduce a streamlined pay structure that will help attract and retain our employees, especially in key shortage areas such as health and education. The new system will also be easier to understand and manage as it will reduce the number of pay grades and consolidate wage and personal allowances. The new structure eliminates the fuel allowance, which was one factor in above-budget spending in the past. The cost of this allowance would rise with increases in fuel prices and destabilize the budget. With the reform, personal emoluments will rise to MK 15.3 billion (including parliamentarians), but remain about 7 percent of GDP; this is in line with countries in the region.
- Repayment of domestic arrears. Each of the ministries covered by the 2004 audit will be expected to clear at least a portion of its arrears within their budget allocation. We

will develop a centralized strategy to ensure that all claims are verified and prioritized to minimize cost before payments are made.

- ADMARC. The budget provides MK 800 million for ADMARC restructuring, and MK 400 million to subsidize the social functions of ADMARC.

17. We do not plan to change any tax rates prior to the mid-year review (see below). Therefore, the budget framework assumes that collections will rise owing to overall income growth, continued efficiency gains at the Malawi Revenue Authority (MRA), and the lagged effects of tax base broadening in late 2002 and rate increases in 2003. We are, however, considering tax changes in the future to make the tax system more efficient and equitable. These could include the elimination of the 40 percent personal income tax bracket, adjustments to the personal income tax brackets, and a small reduction in the surtax rate. These would only be implemented when our financial situation permits. We will request technical assistance from the IMF's Fiscal Affairs Department, to help us analyze the effects of such changes, and estimate the revenue impact. Some user fees and levies will be adjusted to account for past inflation

18. Resources available to the government will also depend on support from our development partners. Because our IMF-supported program has been replaced by a staff-monitored program, direct budget support is on hold. However, as we have made progress in restoring fiscal discipline and monetary control in June and July 2004, we anticipate this flow of resources to resume soon and increase later on as we demonstrate our commitment to sound policies. For the purposes of our budget exercise, we have made conservative estimates of budget support, in part because these flows have been very difficult to predict in the past. We will reevaluate the situation during the midyear budget review (January 2005), when we will devote any additional support to reducing our domestic debt. This will have the long-lasting benefit of lowering interest payments and releasing resources for priority services.

19. As noted above, our fiscal policy objective for this year is to limit borrowing from the domestic economy as much as possible. We are confident that this can be accomplished through a prudent budget, rigorous expenditure management, and a strong MRA. However, our projections show a significant need to borrow in the first quarter of 2004/05 (July-September) followed by three quarters of far less borrowing and some debt repayment. Therefore, this early borrowing should not be seen as an indication of weak budget performance. For this reason, we are looking at ways to keep our citizens, financial markets, and development partners better informed about our budget implementation results.

Improving expenditure management

20. A key purpose of improved expenditure management is to hold spending within the approved budget and avoid the buildup of arrears. We are making progress in this area and soon expect to see benefits. We will begin testing the expenditure information that has recently become available from the RBM's payment system for government accounts, and in

August we designed and tested summary reports of reimbursements compared with the budget. These have been tailored to the needs of key management at the Ministry of Finance and RBM, and could help us to monitor budget execution. We will begin to use this system, first on a testing basis, to reject CCAs (credit ceilings) that exceed the budget. Strengthened communication between the budget monitoring and evaluation division in the Ministry of Finance and the newly established Department of Public Procurement ensures that tenders are only awarded within budget limits. In addition, we are now evaluating our new information management system (IFMIS), and we hope to correct identified deficiencies such as the absence of a cashbook in the near future.

21. We are following through with the implementation of the Public Finance Management, Public Audit, and Public Procurement Acts approved by parliament in 2003. We are currently finalizing treasury instructions to implement the new Finance Act. We have also cleared the backlog of annual final accounts. The 2002/03 accounts will soon be presented to parliament, and we are working to improve further the timeliness of the submission of our accounts as required under the new law.

22. We are also taking steps to strengthen the operations of the Ministry of Finance and the existing manual processes. We are planning to hire five to six additional qualified staff for line positions in the Ministry of Finance and the Accountant General's office (with donor support). The commitment control system and expenditure reporting forms have been redesigned to make reporting easier, and we will continue to prepare quarterly expenditure reports for senior management. An electronic reporting format has been developed which -- after testing -- will increase the reliability of transmission of information from ministries to the Ministry of Finance. The Accountant General will use inspection visits to the ministries to follow up on the implementation of the redesigned commitment control forms, as well as the results of the audit of domestic arrears.

The midyear review

23. We will use the midyear budget review to evaluate our estimates of donor assistance and the cost and savings from government restructuring. Ministries should not expect an increase in their budget allocations because we intend to devote any additional resources to debt reduction. Moreover, we will tighten spending ceilings if revenue and donor support are running below our budget estimates. In this way, we will follow through with our objective to eliminate domestic borrowing.

24. Issues that we expect to cover in the midyear review include

- Savings opportunities. Our budget saving strategy assumes that each ministry will live within its budget ceilings by finding efficient ways to deliver services. However, there are a number of areas where savings could be found across the government and we are currently looking at government-wide policies for vehicles and utilities.

- Government pension. The new civil service wage system will increase government pensions by shifting compensation from allowances to income on which benefits are based. The budget estimate for 2004/05 includes this effect and the medium-term costs and benefits of this outcome need to be studied carefully. However, we have already decided to increase the pensionable age from 55 years to 60 years.
- Tax measures. We will assess whether a small reduction of the surtax rate and modifications of the personal income tax are compatible with the SMP targets.
- Domestic arrears. We will complete the 2004 domestic arrears audit of nine ministries and extend it to cover the rest of government. These ministries will also be expected to clear their arrears with the verification and least cost to government policies discussed above.

B. Monetary and Exchange Rate Policies

25. The aim of monetary policy is to return inflation to the neighborhood of 10 percent within 12 months and reduce it to the 5 – 8 percent range in the medium term. We recognize that the recent monetary expansion and poor harvest will push inflation to the 18-20 percent range around the end of this year. This development underscores the importance of bringing the government's deficit under control and strictly limiting its borrowing from the RBM, because this amounts to the printing of money.

26. The RBM will continue to rely on the broad money stock (M2) as the nominal anchor to control inflation. We have decided to monitor deposits and broad money on a weekly basis and, if we see deviations from their paths consistent with controlling inflation, adjust our main operating instrument net domestic assets (NDA). This intensified monitoring has become necessary because of the unexplained rise in cash held by the general public that cannot be mopped up until it enters the banking system through deposits.

27. We will use open market operations, the purchase and sale of treasury and RBM bills, to control NDA. We have decided to delay planned reductions in the commercial bank liquidity reserve requirement (LRR) because this would add liquidity to the system. Since our decision to reduce the LRR last year, government borrowing increased sharply and caused a liquidity overhang that we must address before the LRR can be lowered. We remain committed to a lower 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.

28. The RBM will also use foreign exchange sales to help mop up excess liquidity that is now in the system. This will serve to ease pressure on interest rates by lowering the amount of treasury and RBM bills sold for mop-up operations. The RBM also needs to maintain a certain level of foreign currency to meet its operating needs and to smooth the kwacha exchange rate by providing a buffer when seasonal or temporary imbalances develop between private sector supply and demand for foreign currencies.

C. Structural Policies

29. Structural measures under the SMP will be limited to those related to fiscal policy and expenditure management. We plan to focus on these areas to ensure the program's success.

30. We will nevertheless continue to work in other key areas identified in the MPRSP. A central element in reducing poverty in the medium term is to remove impediments to growth by providing an environment for the private sector to save, invest, and create jobs. Thus, our strategy, which was developed together with private sector representatives, focuses, in addition to restoring macroeconomic stability, on increasing the availability of financing, improving the tax and incentive system, enhancing basic infrastructure and utility provision, and improving the human capital. To this end, we will restructure government-owned or -controlled financial companies to better serve private sector needs. We will also simplify the tax system, provide more resources to the National Road Authority, and develop a strategy to stabilize the supply of power and water.

31. Furthermore, our recently revived Public Sector Investment Plan will strive to align all development projects to the goals spelled out in the MPRSP. In particular, we are currently putting together a database of projects that will increase the coverage of development projects in the government budget and facilitate the prioritization between projects according to the MPRSP.

IV. PROGRAM MONITORING

32. We have asked the IMF staff to monitor our economic program using the definitions, data sources, and frequency of monitoring set out in the accompanying technical memorandum of understanding (TMU). Submission of the 2004/05 budget that is in line with the budget framework presented here will be considered an important benchmark.

33. Tables 1 and 2 below set out the targets for end-September and end-December 2004 and indicative targets for end-March and end-June 2005. We will announce our monthly funding for wages and noninterest current spending at the beginning of each month and the corresponding outcome within 15 days of the end of the month. Our performance in this area will also be indicative.

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

	End-June 2004 Stock Preliminary Actual	Cumulative Flows Since June 30, 2004					
		2004		2005		2005	
		End-Sep. Target	End-Dec. Target	End-Mar. Indicative Target	End-Jun. Indicative Target	End-Sep. Target	End-Dec. Target
(In millions of Malawi kwacha)							
1. Ceiling on net domestic assets of the Reserve Bank of Malawi (RBM) 2/	18,731	1,344	-1,216	-2,396			-3,743
2. Ceiling on central government's net domestic borrowing (4 commercial banks) 2/	47,104	6,060	6,711	6,247			4,194
3. Ceiling on central government wages and salaries	...	3,400	7,300	11,236			15,300
4. Ceiling on central government discretionary expenditures	...	8,278	20,126	28,071			34,820
(In millions of U. S. dollars)							
4. Floor on net foreign assets (NFA) of the monetary authorities 2/	-0.1	-11.6	-2.9	-13.4			33.9
5. Ceiling on the accumulation of external payments arrears 3/	...	0.0	0.0	0.0			0.0
6. 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. 3/ 4/	...	10.0	10.0	10.0			10.0
7. 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. 3/	...	0.0	0.0	0.0			0.0
Memorandum item: Baseline for balance of payments support (in millions of U.S. dollars)	...	0.0	58.0	84.7			114.3

1/ Targets are defined in the TMU.

2/ Targets are subject to an adjuster for BOP support. See TMU for full explanation.

3/ Evaluated on a continuous basis.

4/ Loan contracted following an agreement by the previous government to purchase communication equipment for the Ministry of Defense.

Table 2. Malawi: Structural Benchmarks Under the Staff-Monitored Program			
	Measure	Implementation Date	Status
1.	Prior actions		
1.1	Move presidency to Lilongwe.		Completed
1.2	Include the new wage strategy within 2004/05 budget framework.		Completed
1.3	Forward the final Anti-Corruption Bureau report on NFRA to the DPP.		Completed
1.4	Submit the 2002/03 public accounts to the Public Accounts Committee of parliament.		Completed
2.	Structural benchmarks		
2.1	Submit to parliament a 2004/05 budget that is consistent with SMP.	End-September 2004	
2.2	Issue Treasury instructions under the Public Finance Management Act.	End-October 2004	Draft completed and circulated
2.3	Submit the 2003/04 public accounts to the Public Accounts Committee of parliament.	End-February 2005	
2.4	Provide check numbers for outstanding checks issued against the 2003/04 budget to RBM for entry into the government account payment system.	End-October 2004	
2.5	Test tailored reimbursement reports and send them to key RBM and Ministry of Finance senior staff.	End-October 2004	
2.6	Test and activate the budget ceiling module that is part of the government account payment system.	End-October 2004	
2.7	Financial control officers to submit to the Secretary of the Treasury a summary of financial transactions within 14 days of the end of each month (monthly expenditure and commitment reports).	October 15, 2004	
2.8	Issue the interim report on the 2004 audit of domestic arrears for nine ministries and solicit donor support for an audit of the remaining ministries.	End-October 2004	

Malawi—Technical Memorandum of Understanding

1. This memorandum sets out the definitions for the quantitative targets under which Malawi's performance under the staff-monitored program 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 TARGETS

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 international reserve assets and international reserve liabilities. NFA will be valued in U.S. dollars at the program exchange rate of MK 108.9 per US\$1 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". The floor is measured as the cumulative flow from July 1, 2004.
4. **Gross international reserve assets** of the monetary authorities are defined as the sum of
 - monetary gold holdings of the RBM;
 - holdings of SDRs;
 - Malawi's reserve position in the IMF;
 - central government (treasury) holdings with crown agents; and
 - foreign currency assets in convertible currencies held abroad that are under the direct and effective control of the RBM, and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution;
 - but exclude 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. **International reserve liabilities** of the monetary authorities are defined as the sum of

- outstanding liabilities of the RBM to the IMF; and
- any foreign convertible currency liabilities of the RBM with an original maturity of up to, and including, one year;
- but exclude liabilities arising from balance of payments support of original maturities of more than 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 by the full amount by which the cumulative receipts from the balance of payments support exceed the program baseline (shown in Table 1 below). The end-June 2005 target will also be adjusted downward by the amount by which the cumulative receipts from balance of payments support are less than the program baseline, up to a maximum adjustment of US\$25 million.

7. **Definition of balance of payments support:** Balance of payments support comprises all grants and loan external 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, 2004.

Malawi: Balance of Payments Support, FY2004/05
(In millions of US dollars)

	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	FY Proj.
Grants (excluding HIPC)	0	33	9	5	47
EU	0	0	9	0	9
UK	0	27	0	0	27
Norway	0	6	0	2	8
Sweden	0	0	0	3	3
Loans	0	25	18	25	68
AfDB	0	0	18	0	18
IDA	0	25	0	25	50
Total	0	58	27	30	114

Sources: UK, EU, Norway, Sweden, 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 are defined as reserve money minus net foreign assets of the monetary authorities. Reserve money consists of currency issued by the RBM and balances of commercial banks accounts with the RBM. It includes required reserves held for Malawi kwacha deposits and any other domestic currency reservable liabilities and other demand and time deposits held with the RBM. The ceiling is measured as the cumulative flow from July 1, 2004.

9. **Adjustment clause on net domestic assets—balance of payments support:** The ceiling on net domestic assets of the RBM will be adjusted downward by the full amount by which the cumulative flow of receipts from balance of payments support exceeds the program baseline. The end-June 2005 target will also be adjusted upward by the amount by which the cumulative receipts from balance of payments support are less than the program baseline, up to a maximum adjustment of US\$25 million. 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).

C. Ceiling on Central Government's Domestic Borrowing

10. **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), 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, 2004.

11. **Adjustment clause on CGDB—balance of payments support:** The ceiling on CGDB will be adjusted downward by the full amount by which the cumulative receipts from balance of payments support exceed the program baseline. The end-June 2005 target will also be adjusted upward by the amount by which the cumulative receipts from balance of payments support are less than the program baseline, up to a maximum adjustment of US\$25 million (see para. 7 for the definition of balance of payments support).

D. Ceiling on Central Government Wages and Salaries

12. **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 allowances and payments on arrears of personnel emoluments. The ceiling is measured as a cumulative flow from July 1, 2004.

13. **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 by the full amount of donor-funded supplementary wages and salaries for the health sector, a facility that is currently being negotiated with donors.

E. Ceiling on Central Government Discretionary Expenditures

14. **Definition of central government discretionary expenditures:** These are all expenditures excluding (i) wages and salaries, (ii) interest payments, and (iii) foreign-financed development expenditures (development expenditures Part I) which are related to specific projects. Central government discretionary expenditure include statutory (i.e., nonvoted) expenditures for pensions and gratuities, and statutory compensations as well as other recurrent expenditures (ORT), domestically financed development expenditures (development expenditures Part II), 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, and purchases financed from the Japan debt relief account (see paragraph 19). The ceiling is measured as a cumulative flow from July 1, 2004.

15. **Adjustment clause on central government discretionary expenditures—donor-funded recurrent expenditures in the health sector.** The ceiling on central government discretionary expenditures will be adjusted upward by the full amount of donor-funded recurrent health sector expenditures, a facility that is currently being negotiated with donors.

F. Ceiling on External Payment Arrears

16. **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.

G. Ceiling on External Debt

17. **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, 1979,¹² 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 on debt with nonresidents. The ceiling applies to debt

⁸ [http://www.imf.org/external/pubs/ft/sd/index.asp?decision=6230-\(79/140\)](http://www.imf.org/external/pubs/ft/sd/index.asp?decision=6230-(79/140)).

and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from July 1, 2004.

18. Excluded from the limit is the use of Fund resources; adjustment lending from the World Bank, the African Development Bank, and other multilateral agencies; 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) debts to restructure, refinance, or prepay existing debts; (iii) normal import financing; and (iv) convertibility guarantees of the kwacha by the RBM. A financing arrangement for imports is considered to be “normal” when the credit is self-liquidating.

II. TREATMENT IN THE FISCAL ACCOUNTS AND BALANCE OF PAYMENTS OF CERTAIN CENTRAL GOVERNMENT (CG) ACCOUNTS HELD ABROAD

19. **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 either separately identified as special activities, or included in spending agencies budgets under current expenditures, or as part II development expenditures (development expenditures financed by the Government of Malawi). Flows are valued at the end-month exchange rate.

20. **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.

21. **The treatment of Emergency Drought Recovery Project (EDRP) funds (a World Bank grant and loan arrangement) in the fiscal accounts:** The resources from this arrangement are allocated for three different purposes: import programs, in support of MASAF, and for technical assistance. The share of resources for import programs is treated

as program support as the kwacha equivalent of the foreign currency resources (which are allocated for imports by the private or public sector by the RBM) received in cash by the Malawi government. The EDRP is recorded as a grant or loan, respectively, when monies are deposited in an account in the name of the RBM held abroad and as foreign financing (increases in deposits). Withdrawals from the account held abroad are recorded as an increase in foreign financing, and presumed to be transferred to an account held in Malawi and counted as part of net credit to government and thus domestic financing (increase in domestic deposits). Expenditures financed from import program resources are included in current expenditures or Part II development expenditures (development expenditures financed by the Government of Malawi), with the exception of a small amount (estimated at MK 400 million) that was already approved for the use by specific development projects. The share of resources for MASAF is treated as project support even though it is received in cash. It is recorded as a grant or loan, respectively, and as Part I development expenditures (foreign financed development expenditures), at the point in time it is received. The share of resources for technical assistance is treated as project support. It is recorded as a loan and as Part I development expenditures (foreign-financed development expenditures), at the point in time it is received. The Government of Malawi will provide detailed accounting by quarter for the EDRP funds, including the share of the different programs and subprograms; the timing of receipt of cash components and noncash components; the share of grants and loans; and the use of the cash components, and the time of that use.

III. REPORTING REQUIREMENTS

22. The authorities have committed themselves to using the best available data, so that any subsequent data revisions will not likely lead to a breach of a performance target. All revisions to data will be promptly reported to the Fund staff, particularly when the changes are significant. The likelihood of significant data changes will be communicated to Fund staff as soon as the risk becomes apparent to the authorities. All data will be reported electronically in the format and frequency set out below and within the period specified.
23. On a **weekly** basis within seven calendar days of the end of the respective week, the balance sheet of the monetary authorities will be reported by the RBM.
24. On a **weekly** basis (each Wednesday) with a two-day lag, daily gross reserves, the daily U.S. dollar to kwacha exchange rate, daily net interventions of the RBM in the foreign exchange market, daily reserve money, the daily net volume on open market operations, the results of treasury bill and RBM bill auctions, and any direct uptake of treasury bills by the RBM will be reported by the RBM.
25. On a **monthly** basis within 30 calendar days of the end of the respective month, the RBM will submit the monetary survey, the monetary authorities' accounts, the commercial banks' accounts (four banks), the international reserves position, local registered stock holdings, treasury bill holdings, interest rates, exchange rates, the consumer price index, new loans contracted or guaranteed by the RBM or other agency on behalf of the central government, and a list of external arrears by creditor, with a detailed explanation.

26. On a **monthly** basis within 30 calendar days of the end of the respective month, the fiscal accounts of the central government, tables summarizing, by line ministries, achievement of commitment levels and arrears in the CCS3 and CCS4 returns, CCA, supplementary CCA, and reimbursement to commercial banks,¹³ central government reports on spending on pro-poor expenditure (PPE) programs, funding reports for wages, and other recurrent expenditure and development expenditure, account statements from the Tokyo-Mitsubishi account, and revenue data (reporting agency: Ministry of Finance); and the SGS import data will be reported (reporting agency: Malawi Revenue Authority).

27. On a **monthly** basis within 45 calendar days of the end of the respective month, the Ministry of Finance will submit a review summarizing the monthly reports by line ministries on commitment levels¹⁴ and arrears, and assessing prospects for meeting budget targets will be reported; and a consolidated table on total financing of the central government, including domestic and foreign financing, will be reported (reporting agencies: Ministry of Finance and RBM).

28. On a **quarterly** basis within 30 calendar days of the end of each quarter, a loan-by-loan accounting of all new external loans contracted or guaranteed by the central government, RBM, or other agencies on behalf of the central government, including detailed information on the amounts, currencies, and terms and conditions, as well as all relevant supporting materials will be reported by the Ministry of Finance.

29. On a **quarterly** basis within 45 calendar days of the end of the respective calendar quarter, the borrowings of the ten major parastatals¹⁵ (reporting agency: Ministry of Finance); a report on performance under the program (reporting agencies: RBM and Ministry of Finance); and a report on the verified expenditure arrears will be transmitted (reporting agency: Auditor General).

¹³ Reporting on CCAs, supplementary CCAs, and reimbursements is suspended until end-October 2004 when the reporting format will have been finalized.

¹⁴ This requirement will be suspended until January 1, 2005 while the Treasury's computer server is repaired.

¹⁵ 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 June 30, 2004)

I. Membership Status: Joined 07/19/1965; Article VIII (December 7, 1995)					
II. General Resources Account:					
	<u>SDR million</u>	<u>% Quota</u>			
Quota	69.40	100.0			
Fund holdings of currency	84.46	121.7			
Reserve position in Fund	2.29	3.3			
III. SDR Department:					
	<u>SDR million</u>	<u>% Allocation</u>			
Net cumulative allocation	10.98	100.0			
Holdings	0.49	4.47			
IV. Outstanding Purchases and Loans:					
	<u>SDR million</u>	<u>%Quota</u>			
Poverty Reduction and Growth Facility (PRGF) arrangements	46.53	67.04			
Emergency Assistance	17.35	25.0			
V. Financial Arrangements:					
<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR million)</u>	<u>Amount Drawn (SDR million)</u>	
PRGF	12/21/2000	12/20/2004	45.11	12.88	
ESAF/PRGF	10/18/1995	12/16/1999	50.96	50.96	
Stand-by arrangement	11/16/1994	06/30/1995	15.00	12.73	
VI. Projected Obligations to Fund, Including Board-Approved HIPC Initiative Assistance (in millions of SDRs; based on existing use of resources and present holdings of SDRs):					
	<u>Forthcoming</u>				
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Principal	3.95	12.36	17.86	13.41	5.37
Charges/Interest	<u>0.46</u>	<u>0.89</u>	<u>0.70</u>	<u>0.41</u>	<u>0.26</u>
Total	4.40	13.25	18.57	13.81	5.64

VII. Implementation of HIPC Initiative:

	<u>Enhanced Framework</u>
A. Commitment of HIPC assistance	
Decision point date	12/21/00
Assistance committed (NPV terms) ¹	
Total assistance (US\$ million)	643.00
<i>Of which:</i> 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 Poverty Reduction and Growth Facility arrangement that was approved on December 21, 2000 and is scheduled to expire on December 20, 2004. An offsite safeguards assessment of the RBM was completed in July 2001. A follow-up on-site safeguards assessment was conducted in May 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.

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 market-determined. On July 30, 2004, the exchange rate was MK 108.94 = US\$1.00.

X. Article IV Consultation:

Malawi is on the standard 12-month Article IV consultation cycle. The last Article IV consultation (EBS/02/131; 7/22/02) was concluded by the Executive Board on August 5, 2002.

XI. Technical Assistance:

<u>Date</u>	<u>Duration</u>	<u>Dept.</u>	<u>Recipient</u>	<u>Purpose</u>	<u>Form</u>
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

XII. Resident Representative:

Mr. Thomas Baunsgaard since August 16, 2004.

Malawi: IMF-World Bank Relations

Contact person: Ms. Yisgedullish Made, 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 new strategy presents a transitional program that aims to help the Government to address the urgent development issues as it is clear that business-as-usual strategy will not achieve the required results.
2. The 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. Two ongoing projects (Financial Management Transparency and Accountability; and Privatization and Utility Reform), and one new project (Global Development and Learning Network) will assist in attaining the objectives under pillar one. To support the objectives of pillar two, the newly approved Community Based Land Reform Project, and two pipeline projects (Infrastructure Services Project, and Agriculture Project) are under the base case. Finally, core Bank interventions under pillar three include the HIV/AIDS project; Third Malawi Social Action Fund Project; Secondary Education Project, and the Emergency Drought Relief Project, in addition to two sectoral projects under preparation in the area of education and health even in a low case.

B. Financial Relations with the World Bank Group

3. The World Bank has been active in Malawi since 1966. The World Bank Executive Board has since approved 94 IDA credits and 10 IBRD loans. Total lending to Malawi from the World Bank as of May 31, 2004 is US\$2,389.6 million, of which US\$2,077.1 million has been disbursed. Currently there are thirteen active projects in Malawi with a net commitment of US\$381.6 million, and an undisbursed balance of US\$252.2 million (as of June 28, 2004). Sectoral breakdown for fiscal year 2004 is as follows: agriculture/ rural at 20%, economic policy at 13%, private sector development and governance at 15%, financial sector at 4%, infrastructure/ transport at 8%, education at 13%, health at 9%, environment at 2% and social protection at 16%.
4. The IFC's equity participation and lending since the inception of its operations in Malawi amounts to US\$31 million (gross) and includes nine investments in agribusiness, textiles, sugar, tourism, chemicals, plywood, a development finance corporation, and a leasing finance corporation. All credits have been fully disbursed. The current IFC portfolio is relatively small, with US\$2.9 million allocated to five ventures. The World Bank's assistance strategy supports policy reform in areas of concern to the IFC, thus aiding its active search for investment opportunities in Malawi.

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

C. Areas in Which the Bank Leads

Education and Health

6. The Multi-Sectoral AIDS Project for (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.

7. In addition, a Health Sector Support project, and Education Sector Support project are under preparation to be presented to the Board in FY05. Other recent operations include a Secondary Education project (US\$48 million) which was approved in FY98 and is slated to close in December 2004, and a Population and Family Planning (US\$5 million) which was approved in FY99 and recently closed after a very successful run.

Social Protection and Community Development

8. 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 Second Malawi Social Action Fund Project (MASAF II, US\$66 million) approved in FY99 just closed after successful implementation. 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

9. 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), there is also an Integrated Infrastructure Services Project to primarily support rural energy, and transport needs.

Privatization

10. 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.

Agriculture

11. A Community based Rural Land Development Project (US\$27 million) has been 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 smallholders. The new Structural Adjustment Credit, which is also ready for Board discussion, will also support agricultural policy reforms (see further details in paragraph 19 below).

Environment

12. 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. However, especially within the framework of MASAF, environmentally-sound community development initiatives are promoted and community resource management projects are funded.

Knowledge Sharing

13. 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

14. 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 provides an in-depth analysis of the new household data.

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

Poverty Reduction Strategy

15. 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 on August 5, 2002 and August 29, 2002, respectively. The IMF and the Bank staff maintained collaborative relationship in supporting the government in the process. The Malawi PRSP is considered by the Bank and the IMF as highly participatory (involving all stake holders), having an appropriate macroeconomic framework including a financing plan with a balanced approach to public policy, and having laid out detailed action plan. In October 2003, staffs of the World Bank and the IMF completed a Joint Staff Assessment (JSA) of the first Malawi PRSP Annual Review.

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

16. Staff of the IMF and the Bank prepared “Malawi: Decision Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative” that was presented to the Board on December 8, 2000. The report recommended a reduction of US\$331 million in Net Present Value (NPV) terms with respect to the debt owed by Malawi to IDA based on a proportional burden sharing approach accounting for 51% of total public debt, (69% of total multilateral debt). This is equivalent to 44 percent of outstanding World Bank group debt in NPV terms at the end of December 1999.

17. The staffs of the IMF and the Bank are currently working jointly on the update of the HIPC Activity Action Plan (AAP) report for Malawi.

Budgetary Planning, Revenues Administration, and Public Expenditure Reforms

18. Bank’s assistance in improvement in public expenditure management has been channeled mainly via its most recent structural adjustment credit. The last adjustment operation, FRDP III, was approved in FY00 and is fully disbursed; it supported budgetary reforms, liberalization of petroleum pricing and marketing, telecommunications and financial sectors, and creation of an affordable social safety net. The FRDP III also comprised a Technical Assistance parallel project that closes at the end of FY04.

19. A new structural adjustment credit has been approved by the Board. The Fiscal Management and Accelerating Growth (FIMAG, US\$50 million) 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.

20. 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

21. The World Bank has financed a study to review civil service and wage policy issues and propose a road map for reform. The Government has agreed to the road map, and has committed to begin implementation of the recommendations of the study in early 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 proposed IMF program.

Humanitarian Assistance

22. The Bank approved an Emergency Drought Recovery Credit (EDRC, US\$50 million, of which US\$21 million is in the form of an IDA grant) in FY03, with the following objectives: 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 an Emergency Credit (US\$23 million) to Malawi in September 2002, to support food imports.

E. Areas in Which the Fund Leads

Macroeconomic Stability, Fiscal Policy, and Monetary Policy

23. 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.