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MALAWI

July 2023

FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM WITH EXECUTIVE BOARD INVOLVEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI

In the context of the First Review Under the Staff-Monitored Program with Executive Board Involvement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 27, 2023, following discussions that ended on May 22, 2023, with the officials of Malawi on economic developments and policies underpinning its *Staff-Monitored Program*. The staff report was approved by IMF Management on July 13, 2023.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Malawi.

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Discussed First Review under Malawi's Staff-Monitored Program with Executive Board Involvement

FOR IMMEDIATE RELEASE

- The Executive Board of the International Monetary Fund (IMF) discussed the first review of the 12-month Staff-Monitored Program with Executive Board involvement (PMB) for Malawi. The review was approved by the Management of the IMF on July 13, 2023.
- In light of a series of shocks, program performance was mixed. The authorities are taking corrective actions to establish a track record of policy implementation, possibly paving the way to an Extended Credit Facility (ECF) arrangement.
- The Executive Board agreed with staff that Malawi is on track to achieve the objectives of the PMB.

Washington, DC – July 28, 2023: The Executive Board of the International Monetary Fund (IMF) discussed the first review of the Staff-Monitored Program with Executive Board Involvement (PMB) for Malawi.

Malawi has been affected by a series of shocks— including an outbreak of cholera and Cyclone Freddy, which caused significant loss of life and damage to infrastructure—since the approval of the PMB on November 11, 2022. In this context, growth has been weaker and inflation higher than expected. The fiscal deficit in FY2022/23 (April/March) was larger than expected at the time of the PMB. Meanwhile, external strains—including shortage of foreign exchange, difficulties securing trade credit, and a widening spread between official and bureau exchange rates—have heightened. Despite a sharp reduction in the current account deficit, accumulation of foreign exchange reserves has been slower than expected, implying an increase in informal trade.

Cyclone Freddy has weighed on the outlook for 2023 and led to a lower growth forecast and a higher inflation forecast. Key downside risks include slippages in program implementation, delays in the ongoing external debt restructuring process, and further external shocks.

Performance under the PMB has been mixed, but the authorities are addressing challenges and continue to commit to the PMB's agreed macroeconomic adjustment path and policy reforms. The authorities are taking corrective actions necessary to demonstrate their capacity to implement the agreed macroeconomic adjustment and reforms, as well as to build the policy track record needed to support their prospective request for an Extended Credit Facility (ECF) arrangement.

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At the conclusion of the Executive Board's discussion, Mr. Bo Li, Deputy Managing Director, and Acting Chair made the following statement:

Steadfast implementation of and unwavering commitment to this Staff-Monitored Program with Executive Board Involvement (PMB) will be critical to restore macroeconomic stability and establish a track record to support a prospective request for an Extended Credit Facility (ECF) arrangement.

Successful debt restructuring is vital to deliver macroeconomic stability. The authorities' external debt restructuring strategy aims to bring external debt service down substantially through a significant treatment of commercial debt and official bilateral debt. A concerted effort among the authorities, their creditors, and their international development partners will be crucial to ensure successful implementation of the external debt restructuring strategy.

Fiscal discipline, supported by a robust Public Financial Management (PFM) system and timely production of comprehensive fiscal reports, remains critical. Concerted effort by the authorities and other domestic stakeholders to prepare for fiscal financing challenges is important. Price stability supported by fiscal consolidation is critical to prevent a further erosion of purchasing power for those living in poverty and food insecurity. Rebuilding buffers is critically important to reduce Malawi's vulnerability to external shocks.

Addressing weakness in governance and institutions remain important priorities, as demonstrated by the recent fertilizer deal, which is concerning from a governance perspective. The authorities' governance and procurement practices should be strengthened to avoid such incidents in the future.

The Management-approved Staff Monitored Program (SMP) is sufficiently robust and remains on track to meet its objectives.

Malawi: Selected Economic Indicators, 2021–28

	2021	2022		2023		2024	2025	2026	2027	2028
	Actual	PMB Approval	Est.	PMB Approval	Proj.			Proj.		
National accounts and prices (percent change, unless otherwise indicated)										
GDP at constant market prices	4.6	0.8	0.8	2.4	1.7	3.3	3.8	4.3	4.5	4.6
Nominal GDP (billions of Kwacha)	9,976	11,354	11,799	14,018	14,768	17,728	20,462	22,948	25,503	28,211
GDP deflator	8.2	17.3	17.3	20.6	23.1	16.3	11.2	7.5	6.3	5.8
Consumer prices (end of period)	11.5	26.0	25.4	20.4	24.4	15.2	9.9	7.6	6.5	6.5
Consumer prices (annual average)	9.3	20.8	20.8	22.7	24.8	18.3	12.2	8.1	6.8	6.5
Investment and savings (percent of GDP)										
National savings	-5.2	-4.8	9.9	-3.6	4.7	2.5	0.7	1.7	3.4	3.6
Government	-5.9	-5.1	-5.6	-7.8	-6.2	-6.4	-5.8	-4.6	-2.3	-1.3
Private	0.7	0.3	15.5	4.2	11.0	9.0	6.5	6.3	5.7	4.9
Gross investment	8.9	9.9	13.1	10.1	12.7	11.5	9.3	9.3	9.8	9.5
Government	6.4	6.9	10.2	7.3	9.9	8.7	6.2	5.8	5.5	5.4
Private	2.6	3.0	3.0	2.8	2.8	2.8	3.1	3.4	4.2	4.2
Saving-investment balance	-14.1	-14.8	-3.2	-13.6	-7.9	-9.0	-8.6	-7.6	-6.3	-5.9
Central government (percent of GDP on a fiscal year basis)[1, 2]										
Revenue	14.6	15.4	14.3	15.5	17.4	17.7	19.8	18.9	17.3	18.1
Tax and nontax revenue	12.9	13.4	12.5	13.9	13.5	14.9	17.5	17.2	15.9	17.0
Grants	1.7	1.9	1.8	1.6	3.9	2.7	2.3	1.6	1.4	1.1
Expenditure and net lending	21.9	24.3	22.6	24.6	29.3	27.5	27.8	25.4	23.6	23.1
Overall balance (excluding grants)	-9.1	-11.6	-10.8	-10.6	-15.8	-13.2	-11.7	-9.0	-7.8	-6.2
Overall balance (including grants)	-7.4	-9.7	-9.0	-9.0	-11.8	-10.5	-9.4	-7.3	-6.4	-5.0
Foreign financing	1.3	2.8	2.6	-0.6	3.3	0.6	0.0	-0.1	-0.4	-0.2
Total domestic financing	8.0	7.4	6.9	5.6	8.5	8.4	8.6	6.4	6.6	5.3
Financing gap/residual gap	0.0	0.0	0.0	4.1	0.0	1.5	0.8	1.0	0.2	0.0
Discrepancy	-0.1	-0.8	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	-3.6	-5.4	-5.0	-3.3	-6.8	-4.9	-1.6	1.2	1.5	2.1
Domestic primary balance[3]	-2.5	-4.1	-3.8	-0.6	-3.8	-2.8	0.5	2.9	2.8	3.1
Money and credit (change in percent of broad money at the end of the period, unless otherwise indicated)										
Broad money	30.0	27.5	38.8	23.5	25.2	20.0	15.4	12.2	11.1	10.6
Net foreign assets	-3.9	42.1	-13.8	19.1	-5.3	8.4	2.8	7.2	4.4	6.3
Net domestic assets	33.9	-14.6	52.6	4.3	30.5	11.7	12.6	5.0	6.7	4.3
o/w Net claims on the government	41.0	28.0	39.0	26.0	26.1	18.8	10.6	14.3	10.5	15.3
Credit to the private sector (percent change)	22.2	27.9	24.1	14.7	16.0	8.2	5.1	8.6	8.8	10.4
External sector (US$ millions, unless otherwise indicated)										
Exports (goods and services)	1,191	1,294	1,125	1,421	1,322	1,454	1,568	1,662	1,814	1,940
Imports (goods and services)	3,332	3,406	1,835	3,173	2,487	2,608	2,700	2,744	2,818	2,936
Gross official reserves[4]	429	172	120	409	499	747	846	996	1,106	1,202
(months of imports)	1.6	0.6	0.6	1.5	2.3	3.3	3.7	4.2	4.5	4.7
Net international reserves[5]	-834.8	-584.1	-1,237.9	-312.2	-673.1	-594.4	-575.9	-438.7	-321.4	-156.3
Current account (percent of GDP)	-14.1	-14.8	-3.2	-13.6	-7.9	-9.0	-8.6	-7.6	-6.3	-5.9
Current account, excl. official transfers (percent of GDP)	-14.1	-14.8	-3.8	-13.6	-7.9	-8.9	-8.6	-7.5	-6.3	-5.9
Current account, excl. project related imports (percent of GDP)	-12.0	-12.3	0.2	-10.8	-4.3	-5.8	-6.3	-5.7	-4.9	-4.3
Real effective exchange rate (percent change)	-5.7	...	2.9	...	...	...	...	...	...	...
Overall balance (percent of GDP)	0.0	-1.7	-0.1	-2.4	-2.6	0.1	-0.2	0.0	0.6	1.2
Financing gap (percent of GDP)	0.0	2.8	0.0	4.9	5.8	2.6	1.6	1.9	0.8	0.1
Terms of trade (percent change)	-19.0	-14.9	-14.3	-0.5	11.4	-1.8	1.8	2.2	2.1	-0.9
Debt stock and service (percent of GDP, unless otherwise indicated)										
External debt (public sector)	31.5	38.9	34.4	37.1	37.1	35.3	33.5	30.9	28.8	27.0
NPV of public external debt (percent of exports)	218.6	202.3	264.7	176.6	187.1	162.3	145.9	132.3	119.3	110.1
Domestic public debt[6]	30.0	37.7	40.8	37.5	43.2	44.9	47.4	48.6	49.3	48.1
Total public debt[6]	61.5	76.6	75.2	74.6	80.2	80.2	80.9	79.6	78.1	75.1
External debt service (percent of exports)	15.2	55.6	12.0	26.7	59.8	25.2	20.1	18.3	12.9	10.6
External debt service (percent of revenue excl. grants)	4.9	43.2	7.8	24.6	44.7	23.6	18.7	17.0	11.6	9.4

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

[1]The financial year, 2021, runs from July 1, 2020 to June 30, 2021. FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year. starting from FY2022/23.

[2]Please note that government fiscal statistics are reported following the Government Finance Statistics Manual (2014) starting 2020 projections and going forward.

[3]Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and nontax revenues.

[4]Gross official reserves figures include encumbered deposits in 2021; all figures from 2022 onwards do not include encumbered deposits. Readily available gross official reserves were US$71.7

[5] 2021 NIR is calculated as gross official reserves minus a sum of Use of Fund Credit, repayments projection of medium-term debt by remaining maturity, and short-term swap outstanding. 2022 NIR is calculated as define in the TMU at the time of the PMB application. Thereafter, the net international reserves reported not only subtract foreign currency drains (FCD) as defined in the TMU of the First Review of the PMB, but also all outstanding foreign currency debt service to external creditors to which the RBM (including as an agent of the government) is in arrears and or servicing via other means, in line with debt restructuring strategy.

[6]Domestic debt is at face value and future borrowings is at cost value.

MALAWI

July 13, 2023

FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM WITH EXECUTIVE BOARD INVOLVEMENT

EXECUTIVE SUMMARY

Context and recent developments. Malawi has been affected by a series of shocks—including an outbreak of cholera and Cyclone Freddy, which caused significant loss of life and damage to infrastructure—since the approval of the Staff-Monitored Program with Executive Board Involvement (PMB) on November 11, 2022, and the disbursement of $88.3 million in emergency financing under the Food Shock Window of the Rapid Credit Facility on November 21, 2022. In this context, growth has been weaker and inflation higher than expected. The fiscal deficit in FY2022/23 (April/March) was larger than expected at the time of the PMB. Meanwhile, external strains—including shortage of foreign exchange, difficulties securing trade credit, and a widening spread between official and bureau exchange rates—have heightened. Despite a sharp reduction in the current account deficit, accumulation of foreign exchange reserves has been slower than expected, implying an increase in informal trade.

Outlook and risks. Cyclone Freddy has weighed on the outlook for 2023, and led to a lower growth forecast and a higher inflation forecast. The approved FY23/24 budget is in line with the program parameters, and the medium-term fiscal consolidation path is largely unchanged. Key downside risks include slippages in program implementation, delays in the ongoing external debt restructuring process, and further external shocks.

Program performance. Performance on Quantitative Targets (QTs), Indicative Targets (ITs), and Structural Benchmarks (SBs) was mixed, with four out of six end-December and continuous QTs and one out of three end-December ITs not met. Four out of seven Structural Benchmarks were not met. The authorities have committed to strong corrective actions.

Modification of QTs and indicative targets ITs. The authorities requested to IMF staff modifications of QTs and ITs for end-June and end-September, in line with updated program projections, which were approved by Management. In consultation with IMF staff, the authorities also have proposed to revise the definition of the net international reserves (NIR) in the Technical Memorandum of Understanding (TMU) to avoid

unnecessary volatility relating to uncertainties surrounding the timing of the debt restructuring process.

Policy commitments. The authorities are taking corrective actions necessary to overcome mixed performance and implementation challenges with the PMB to date, allowing them to demonstrate their commitment and capacity to implement the agreed macroeconomic adjustment and reforms to build the policy track record needed to support their request for an Extended Credit Facility (ECF) arrangement.

Staff's views. Staff assesses that the program remains on track to achieve its objectives.

Approved By
Costas Christou (AFR) and Bjorn Rother (SPR)

The discussions in Lilongwe took place May 16–22, 2023; the staff team consisted of Mika Saito (head), Farayi Gwenhamo (resident representative), Erin Nephew, Jacinta Bernadette Shirakawa, Jung Eun Yoon (all AFR), and Liam Crowley Reidy (SPR). The team met with H.E. President Chakwera, the Hon. Sosten Gwengwe (Minister of Finance), Dr. Wilson Banda (Governor of the Reserve Bank of Malawi, RBM), other senior government and RBM officials, representatives from the private sector and the international community. Camille Bravo and Rohan Singh Ahluwalia assisted with the preparation of this report.

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CONTEXT AND RECENT DEVELOPMENTS

1. **Malawi has been affected by a series of shocks since the approval of the PMB, including an outbreak of cholera and cyclone Freddy.** Real GDP growth in 2022 decelerated sharply to 0.8 percent, as projected in the PMB, from the revised official rate of 4.6 percent in 2021. This reflected two tropical storms that hit Malawi in the first quarter of 2022, interruptions to electricity supplies due to damaged turbines, shortened 2021/22 agricultural season rains, and spillover effects from Russia's war in Ukraine through higher fuel, fertilizer, and food prices. From late 2022 to early 2023, Malawi experienced its worst outbreak of cholera in decades, forcing the closure of schools and businesses. Then, in the first quarter of 2023, southern Malawi was hit by Cyclone Freddy, resulting in a significant death toll and the destruction of critical infrastructure.

2. **In this context, inflation has been roughly the same as expected for end-2022.** Average inflation was 20.8 percent in 2022, up from 9.3 percent in 2021. However, inflation (y-o-y) continues to rise and reached 29.3 percent in May 2023. Inflation was driven by both food and non-food items, reflecting passthrough from a 25-percent currency devaluation in May 2022, high global prices for fuel, fertilizer, and food, and prolonged supply disruptions. In April 2023, the Reserve Bank of Malawi (RBM) raised the policy rate to 22 percent, from 18 percent to signal its policy stance. Money growth, which has also been fueling inflation, has begun to decelerate, but achieving price stability will also require reducing the fiscal deficit and related government borrowing, which has been driving money creation and crowds out private sector access to financing.

3. **The fiscal deficit in FY22/23 (April/March) was larger than expected at the time of the PMB.** Revenue came in higher than expected, reflecting larger project grants to help Malawi cope with the series of shocks, but expenditure overruns were even larger, partly reflecting higher spending needs associated with higher food, fuel, and fertilizer prices, the cholera outbreak, and Cyclone Freddy. Moreover, the previously budgeted expenditures took longer to slow than anticipated due to weaknesses in public financial management (PFM). In addition, the May 2022 currency devaluation gave rise to losses at the RBM, due to its net-negative foreign asset position. By law, the government was required to recapitalize the RBM at the end of the calendar year, which increased government capital transfers by 1.4 percentage points of GDP.As a result, the overall deficit reached 11.8 percent of GDP, compared with 9.0 percent projected at the time of the PMB. The domestic primary deficit was 3.8 percent of GDP compared with the PMB's 0.6 percent.

4. **Meanwhile, external strains—including shortages of foreign exchange, difficulties in securing trade credit, and a widening spread between official and bureau exchange rates—have heightened.** A sharp contraction in reported imports reduced the current account deficit to 3.2 percent of GDP in 2022, much narrower than the 14.8 percent of GDP projected at the time of the PMB and the 14.1 percent of GDP outturn in 2021. This is consistent with the depreciation of the exchange rate and reported difficulties in acquiring foreign exchange. But it is also likely to reflect an increase in informal imports (corroborated, for example, by the large discrepancy between fuel imports data from the customs authority and other sources), in the context of stigma associated with transacting away from the official exchange rate. Notwithstanding this uncertainty in relation to

the accuracy of the official data (which are still subject to revision), anecdotal accounts provided by the authorities and others do support the notion that the cost and difficulty of securing foreign currency have weighed on private sector consumption and investment in some sectors of the economy.

5. Despite the sharp reduction in the current account deficit, FX reserve accumulation has been slower than expected. As of end-2022, gross official reserves stood at 1 percent of GDP. This is consistent with foreign currency leaving the country via informal imports, as described above, or other outflows of capital. The RBM has struggled to accumulate reserves, despite the imposition of surrender requirements on exporters, in part reflecting pressure to provide foreign exchange to meet demand from importers following a withdrawal of international banks confirming letters of credit (LCs), particularly for fuel and other strategic imports. In addition, rollover risks of the RBM's foreign currency swaps materialized near the end of 2022, and the stock of foreign exchange reserves thus remained low.

OUTLOOK AND RISKS

6. Cyclone Freddy is expected to weigh on growth and push up inflation in 2023. Growth has been downgraded to 1.7 percent from 2.4 percent projected at the time of the PMB. Average inflation is expected to reach 24.8 percent, up from 22.7 percent projected at the time of the PMB.

7. The approved FY23/24 budget envelope is larger than at PMB approval, mostly to accommodate capital injections to the RBM. The key challenge for the authorities will be to execute the FY23/24 budget as passed and avoid further fiscal slippages which are already jeopardizing the PMB's objective to reduce domestic financing. The promissory note the government issued in December 2022 for central bank recapitalization will be partially offset in FY2023/24 when central bank dividends are posted. Even still, further capital injections will be needed into the medium term, as the RBM is likely to retain a net liability position for some time. The projected capital injection peaks at an estimated 2.2 percent of GDP in FY23/24 and then should wind down as net foreign assets increase and the pace of currency depreciation slows down.

8. Fiscal sustainability and the completion of the PMB relies on a successful conclusion of the government's external debt restructuring process in the near future. The successful completion of negotiations would provide debt relief and open a pathway to an Extended Credit Facility (ECF) arrangement, which would mobilize much-needed grant financing. Thus, time is of the essence, and it will become more challenging to close financing gaps the longer debt restructuring negotiations go on.

9. The balance of risks remains tilted to the downside. The risks of deferring policy adjustments or a prolonged debt restructuring process, which would delay the prospective ECF arrangement and the nondebt-creating inflows it would catalyze, remain high. Weaker-than-expected policy implementation, which would result in wider financing gaps, greater monetary financing of fiscal deficits, and further pressure on inflation and the exchange rate, thus undermining efforts to achieve macroeconomic stability. Other risks to the outlook include further weather-related shocks or another surge in food, fuel, or fertilizer prices. Upside risks include a faster-than-anticipated macroeconomic impact of policy actions, faster-than-expected development of mining projects, successful export diversification and formalization of informal activity, and budget overperformance.

PROGRAM PERFORMANCE

10. Performance on Quantitative Targets (QTs), Indicative Targets (ITs), and Structural Benchmarks (SBs) was mixed, with four out of six end-December and continuous QTs and one out of three end-December ITs not met. Moreover, four out of seven SBs were not met. Contributing factors include difficulties in slowing previously budgeted expenditures and in reducing overreliance on the central bank to supply foreign exchange, delays in the external debt restructuring process, and the unanticipated consequences of the kwacha devaluation, such as the statutorily required recapitalization of the central bank and higher prices for goods and services purchased by the government.

11. The authorities are implementing strong corrective actions. These include committing to adhere to the FY23/24 budget, including through quarterly allotments aligned with realistic revenue projections, rebuilding foreign exchange reserves, enhancing coverage, timeliness, and reporting of the repository of guarantees and underlying contracts to IMF staff, and completing two prior actions for the first review, namely: (i) submitting April and May Integrated Financial Management Information Systems (IFMIS) reports to IMF staff and (ii) restarting foreign exchange auctions to facilitate price discovery in the foreign exchange market. Both prior actions were met.

POLICY DISCUSSIONS

Discussions focused on corrective actions necessary to overcome mixed performance and implementation challenges with the PMB to date, allowing the authorities to demonstrate their commitment and capacity to implement the agreed macroeconomic adjustment and reforms to build the policy track record needed to support their future request for an ECF arrangement.

A. Fiscal Policy: Containing Domestic Borrowing and Regaining Fiscal Discipline

12. The FY2023/24 budget incorporates larger expenditure and domestic financing than anticipated at PMB approval. While accounting for the RBM recapitalization, the budget aims to keep other spending within a realistic envelope compared to revenue. The budget is anchored on realistic revenue estimates and a rationalization of expenditure including by containing the wage bill that would grow below inflation, while protecting social spending, to achieve an improvement in the domestic primary balance (excluding those flows related to recapitalization of the RBM) of about 1.3 percentage points of GDP in FY2023/24, compared with 1.4 percentage points of GDP envisaged at the program approval. The overall deficit would narrow by 1.3 percentage points of GDP (compared with 0.6 percentage change in the PMB), as interest payments would come down faster than originally anticipated. Domestic financing would be in line with the outturn in FY2022/23, yet much larger than anticipated at PMB approval.

13. The authorities have introduced new revenue measures and strive to contain spending. Revenue measures amounting to MWK 57 billion (0.4 percent of GDP) include: the introduction of a temporary supernormal bank profits tax (MWK17.5 billion), increasing the rate on advance income tax to 10 percent from 3 percent (MWK6.6 billion), introducing the requirement for affixing or printing of electronic tax stamps on beverages (MWK6 billion), introducing new stamp duties on various instruments, including motor vehicles (MWK4 billion), and introducing presumptive tax for small businesses whose turnover is less than MWK12.5 million (MWK2 billion). Some of these measures are new, and some were initially planned for FY22/23 but are now being implemented with a delay. Further actions to rationalize tax exemptions would be welcome. On the expenditure side, the budget remains tight, with expenditure rationalized as much as possible without cutting into social expenditure. A large interest bill on domestic debt (5.9 percent of GDP) increasingly limits the authorities' room for discretionary, or even statutory, spending.

14. Expenditure rationalization will continue to be implemented without reducing support to the poor and vulnerable. The authorities succeeded in delivering on social spending commitments made at the time of the PMB, when the IMF also disbursed $88.3 million in emergency financing under the Food Shock Window of the Rapid Credit Facility. Spending on food security—including on social cash transfers, the Affordable Inputs Program, maize purchases, livestock development initiatives, maize seed subsidies, and other agricultural sector spending—met the established targets and is expected to continue into FY23/24, along with heightened health expenditure related to management of the recent cholera outbreak.

15. Steadfast implementation of the budget, including PFM measures, is now needed to keep the PMB on track. It would be critical to implement PFM commitments, including putting allotments, commitments, and cash outlays through Integrated Financial Management Information System (IFMIS). In this context, the authorities have committed to announce quarterly allotments aligned with the macroeconomic framework and the outturns for revenue, grants, and expenditure, and to allow Ministries, Departments and Agencies (MDAs) to commit only up to their allotment through IFMIS. Implementation of IFMIS, institutionalizing reporting, and expanding its coverage continue to be critical for improved budget execution and strong commitment controls.

16. Without any room for fiscal slippage, concerted effort by the authorities and other domestic stakeholders to prepare for fiscal financing challenges is important. If there is slippage in the execution of the budget, there are two ways to fill the additional financing gap, but none are easy options. Additional domestic borrowing will lead to a further pressure on money growth, the exchange rate, and inflation, and further erode the purchasing power of the population already living in poverty and food insecurity. A further cut in primary expenditure or other expenditure are alternative options, including faster rationalization of the wage bill and more aggressive winding down of the Affordable Inputs Program (AIP) in exchange for more targeted support to the most vulnerable. The former will compromise the already-limited delivery of public goods and services and ultimately the attainment of the Malawi Vision 2063. The latter may risk financial sector instability, if not managed well. None of them are easy options and hence contingency planning is important especially in the current environment where discussions to secure additional external sources (grants, concessional loans, external debt relief) are already exhaustively accounted for to execute the budget as passed.

17. The authorities intend to clear the backlog of domestic arrears. They have verified arrears of national budget entities up to March 31, 2022. They have prepared a draft strategy to clear arrears so that settlement respects the limits of the fiscal framework and available resources. The draft strategy has not yet been approved by the Cabinet (SB, ¶33). Going forward, strengthened commitment controls in arrears and quarterly allotments and contract management would help the government to prevent further accumulation of arrears.

18. The authorities have taken important steps to strengthen the oversight of state-owned enterprises (SOEs). In compliance with the new PFM Act, they have initiated detailed reporting for high-risk SOEs, undertaken regular monitoring of the management accounts of relevant SOEs, and prepared an annual consolidated report of all SOEs. These steps will help prevent fiscal slippages and mitigate fiscal risks stemming from public enterprises, assuming the reports are made available on a timely basis, which will continue to be difficult given staffing and data-complication challenges.

B. Achieving Price Stability and Maintaining Financial Soundness

19. The RBM has raised the policy rate and will remain vigilant to address inflation, but excessive money growth must be curtailed quickly. The authorities will implement measures to contain money growth, including the sterilization of excess liquidity created through foreign exchange purchases by the RBM to build up reserves. They also commit to maintain a tight monetary policy stance by setting the policy rate to ensure positive real interest rates. The RBM will also work to contain net claims on government to meet the quantitative target on zero ceiling on RBM financing of the government.[1]

20. In the absence of other government financing sources, banks will have to continue increasing their exposure to government securities, posing concentration risks and squeezing their ability to engage in growth-enhancing lending to the private sector. The banking sector is currently well capitalized, with sufficient profitability but liquidity seems to be at times inadequate (Figure 3). The further increase in the exposure of the banking sector to the public sector and further increases in interest rates may pose potential risks to the soundness of the banking sector. The authorities have committed to remain vigilant to these risks and continue to strengthen financial sector oversight.

[1] The issuance of promissory notes to recapitalize central bank losses from exchange rate movements (required by law) will be adjusted for the zero ceiling on RBM financing of the government.

C. Rebuilding External Buffers

21. Rebuilding a foreign exchange buffer is critical to regain confidence in the foreign exchange market. The low level of official FX reserves has led to a loss of market confidence and shortages of foreign exchange and trade credit. As a result, the RBM is facing higher demand for foreign exchange sales to secure strategic imports, which in turn is making reserve accumulation more difficult. Moreover, the RBM has accrued losses due to its net foreign exchange liability position, putting pressure on the fiscal balance. The RBM has committed to reverse this vicious circle by purchasing foreign exchange and at the same time limiting foreign exchange sales to the market. The authorities are also mitigating foreign exchange swap rollover risks and decreasing financing costs by winding down foreign exchange swaps with non-residents in accordance with their plan to reduce the open swap position over the medium term.

22. The RBM is committed to allow greater flexibility and to reduce misalignment in the exchange rate by facilitating the price discovery process through foreign exchange auctions. A wider spread between the official exchange rate and the bureau rate distorts market incentives and creates fertile ground for corruption and smuggling. The RBM has committed to resume regular and transparent foreign exchange auctions to address these issues and to foster the development of the interbank foreign exchange market **(prior action).** The first such auction was conducted on June 19, in small size but with high participation by authorized dealer banks. The official exchange rate depreciated 2.7 percent in response. The authorities have published the results of this auction and shared relevant details with IMF staff. The authorities also committed to continue those auctions on a monthly basis.

D. Restoring Debt Sustainability

23. Malawi's external debt is currently assessed to be unsustainable but would be considered sustainable on a forward-looking basis if the government is successful in its restructuring strategy. The authorities are committed to bringing external public debt back to a moderate risk of debt distress in the medium term through a combination of policy adjustment and debt treatment. Under the authorities' external debt strategy, which remains consistent with that announced at the time of the PMB, all external solvency and liquidity ratios in the Debt Sustainability Analysis cross their respective thresholds under the baseline forecast in the next five years. The strategy also assumes mobilization of non-debt-creating flows to ensure that external and fiscal financing gaps are closed over the medium term, including through the debt treatment and the mobilization of external grant support from development partners.

24. The authorities continue to engage in negotiations to achieve debt restructuring, which staff assesses to represent a challenging but credible path to external debt sustainability. Nevertheless, risks have increased since the time of the PMB request. Of its largest commercial creditors, Malawi remains in arrears with Trade and Development Bank (TDB)—as agreed to facilitate further negotiations—and is current on its obligations to AFREXIM Bank.

Progress remains slow in these negotiations. Malawi is in the process of obtaining credible and specific financing assurances from official bilateral creditors.

25. Meanwhile, the domestic debt burden is eroding much-needed fiscal space for maintaining public services, providing social safety nets, and investing in human and physical capital. The interest costs of that debt are projected to remain elevated in the medium term -- underscoring the need for urgent fiscal consolidation and the limited margin to respond to future shocks.

26. Malawi is improving debt management, monitoring, recording, and reporting with the support of IMF and World Bank technical assistance. To enhance public debt management, the authorities have updated and published a medium-term debt strategy (MTDS) to take into account on-budget externally and domestically-financed projects. The MTDS also reflects the ceiling on new non-concessional external debt contracted or guaranteed.

E. Tackling Governance Challenges

27. The authorities are taking important steps to improve fiscal transparency and data recording, reporting, and monitoring, at both MOFEA and RBM, to prevent the use of public resources for private gain.

28. The authorities continue to implement corrective actions related to audits of COVID-19 expenditure and the audit of the Export Development Fund (EDF). Preparations are underway for specific follow-up actions needed to implement audit recommendations for EDF and the two tranches of COVID-19 spending (structural benchmark for October 2023). Law enforcement actions related to COVID-19 spending have been fully carried out, but work remains to be done on compiling and implementing audit recommendations to prevent future misappropriation of funds.

29. The authorities are working towards strengthening the anti-corruption agenda but more progress is needed. In accordance with this agenda, the authorities have already taken important steps, including operationalizing a Financial Crimes Court. They are also working to digitalize asset declarations and to facilitate lifestyle audits; and to strengthen collaboration among the Financial Intelligence Agency and the Director of Public Prosecutions in tracing, freezing, and confiscating assets. Moreover, a Memorandum of Understanding between the Anti-Corruption Bureau and various agencies to facilitate data sharing is being prepared. The authorities are also making efforts to reduce smuggling by publishing and reconciling strategic import data. The AML/CFT regime, in particular its legal and regulatory framework, continues to need strengthening to bring it in line with the Financial Action Task Force (FATF) standard. Finally, the authorities requested IMF technical assistance to conduct a governance diagnostic.

30. The authorities have renewed their commitment that public procurement is conducted transparently and in full accordance with proper procedures and the PFM Act. It was reported in the press that the authorities recently undertook a barter trade deal to secure access to fertilizer in exchange for crops, avoiding the use of scarce foreign exchange. The deal raised a number of governance concerns, not least because proper procurement and authorization procedures were not followed on the Malawi side, as confirmed in the Attorney General (AG)'s legal opinion on this matter. The authorities have since undertaken a number of corrective actions, including taking all the necessary steps to nullify this deal and to avoid recurrence of such incidences in the future, confirming that the Fund has the full repository of contracts that would give rise to actual or contingent external debt liabilities of the government and the RBM, confirming their commitment to adhere to the limits on contracting and guaranteeing non-concessional and concessional external debt set forth in the PMB, and requesting a governance diagnostic technical assistance from Fund staff.

PROGRAM MODALITIES

31. Performance on QTs, ITs, and SBs was mixed, with four out of six end-December QTs not met.

- The QT on the domestic primary fiscal balance (floor) at end-December 2022 and the IT at end-March were not met, but the size of the deviation was contained in the latter. This fiscal outturn partly reflects implementation challenges. Revenue targets were met, as were the targets on social spending.
- The continuous QT on zero ceiling on contracting or guaranteeing of new nonconcessional external debt was not met because: the TMU defines this ceiling as a cumulative flow from the beginning of the fiscal year; while there were no contracting or guaranteeing of new nonconcessional external debt since the beginning of the program, a guarantee of US$50 million that had been extended before the program approval but still during FY2022/23 constituted a breach of the program target.
- The QT on the change in net international reserves (NIR) of the RBM (floor) was missed by US$7 million at end-December and the IT for end-March was met.

    - Reserve assets of the RBM (or gross official reserves in Table 1) were projected at US$172 million at the program inception but the outturn was lower at US$120 million largely because of unanticipated realization of rollover risks associated with foreign currency swaps (US$100 million) which was only partially offset by savings in government forex spending.
    - Foreign currency drains (FCD) were projected at US$756 million at PMB approval but the outturn was much higher at US$1,358 million mostly because the debt service arrears that were due to be restructured before end-2022 (and hence was assumed to be excluded from FCD in the next 12 months) became part of FCD.
    - NIR (equal to reserve assets minus FCD) therefore ended 2022 at -US$1,238 million which was much larger negative than the -USD$584 million projected at PMB approval.
    - The QT was set on the change rather than the level of NIR to assess the authorities' efforts in rebuilding NIR; thus, despite this large shortfall, the QT was missed only by US$7 million for end-December 2022 and met for end-March 2023.

  - Going forward, it is proposed to split the FCD into two parts: (i) predictable, steady foreign currency drains of the RBM; and (ii) part that is subject to progress on the debt restructuring process. Only the former would be included to monitor program targets (that is under the control of the RBM) while both would be included in the assessment of Malawi's vulnerability to external shocks.
- The QT on accumulation of external payments arrears was met on a continuous basis as of end-December 2022 and end-March. As set out in the Technical Memorandum of Understanding (TMU), this excludes external debt subject to rescheduling or restructuring based on the government's external restructuring strategy.
- The QT on RBM financing of the central government (ceiling) at end-December 2022 and the IT for end-March were not met, but this was largely because: (1) the government was required by law to provide an automatic recapitalization of the RBM to address its losses following the 25-percent kwacha devaluation in May 2022 and (ii) the RBM was not able to partially net out the losses with a positive profit until April 2023.
- The QT on the monetary base was met both for end-December 2022 and end-March 2023.
- The IT on contracting or guaranteeing of new concessional external debt was not met. Similar to above, the ceiling has been defined as a cumulative flow, starting from the beginning of the fiscal year, while the program target was set from the beginning of the program in November. Since the beginning of the program, the government contracted one new concessional loan with African Development Bank, amounting to XUA1.64 million (about USD 2.1 million), which on its own would not have constituted a breach.

32. The authorities are committed to making expedited progress on Structural Benchmarks (SBs). Progress to date has been mixed. As of the first review, three structural benchmarks were met on time. The SB on quarterly allotments was met. The SB on the strategy to clear arrears was not met. The SB on publication of audited quarterly reports will be replaced with publication of monthly reports (a stronger and more timely commitment). The SB on foreign exchange auctions, which has been elevated to a prior action for the first review, was met. The authorities have requested a modification of the SB on the submission of amendments to the RBM Act to Parliament by end-October 2023 (second review), as consultation with Fund staff is still ongoing; this will be replaced with submission to public consultation first then to the Parliament, by end-October. The SB on the Asset Liability Management Committee (ALCO) was not met, though the ALCO had its first meeting in June. Finally, the SB to produce a follow-up action report on recent audit recommendations is on track for October 2023.

33. The authorities requested modification of QTs and ITs for end-June and end-September, in line with updated projections. In consultation with IMF staff, the authorities also proposed to revise the definition of the NIR to avoid unnecessary volatility due to uncertainties surrounding the timing of the debt restructuring process.

34. In line with prior actions established for the first review of the PMB, the authorities submitted to IMF staff the April and May IFMIS reports, and began in June conducting regular auctions of foreign exchange to facilitate price discovery in the foreign exchange market.

There remain technical issues to iron out with future submissions of IFMIS reports, including adding the full set of MDAs into the data set, and arranging outputs in a user-friendly way that allows for easy comparison against revenue targets and quarterly expenditure allotments. IMF staff will continue to work with the authorities to strengthen the usefulness of the monthly IFMIS reports.

35. **The RBM is making progress in addressing items from the 2021 safeguards assessment.** The RBM recently adopted a risk management policy and aligned procedures for market operations with the RBM Act. A revised framework for management of foreign reserves was recently prepared in consultation with Fund staff and submitted for endorsement by the Board. Staff is following up with the authorities on other outstanding recommendations, including on the amendments to the RBM Act (SB) and the external auditors' verification of Net International Reserves (NIR) data within ten weeks after each test date, which has been delayed for the end-October 2023 test date.

36. **Risks to the program.** Policy implementation remains the key risk. A slower- or weaker-than-expected implementation would create wider financing gaps, greater monetary financing of fiscal deficits, and further pressure on inflation and the exchange rate, thus undermining efforts to achieve macroeconomic stability.

STAFF APPRAISAL

37. **Performance under the PMB has been mixed but the authorities are committed to strengthen policy implementation and establish a strong track record.** They are addressing implementation challenges and are re-committed to the PMB's agreed macroeconomic adjustment path and policy reforms. Steadfast implementation and unwavering commitment would be critical to restore macroeconomic stability, successfully complete the second review, and establish a track record to support their request for a perspective ECF arrangement. The recent fertilizer deal is concerning from a governance perspective. The authorities' procurement practices should be strengthened to avoid such incidences in the future, supported by the corrective actions taken by the authorities.

38. **Successful debt restructuring is vital as there is no reasonable mix of adjustment and financing alone that can deliver macroeconomic stability.** The authorities' external debt restructuring strategy aims to bring external debt service down substantially through a significant treatment of commercial debt and official bilateral debt. A concerted effort among the authorities, their creditors, and their international development partners will be crucial to ensure successful implementation of the external debt restructuring strategy. The burden sharing envisaged under the program will put Malawi on a recovery path, while protecting the poor and vulnerable population. Time is of the essence for adjustment, financing, and especially debt relief, as further delays would result in greater financing gaps, which could then only be closed at an undesirably high cost to the people of Malawi.

39. Fiscal discipline, supported by a robust PFM system and timely production of comprehensive fiscal reports, remains critical. Fiscal consolidation plans, anchored on enhanced revenue mobilization, expenditure rationalization and mobilization of grants, will need to be supported by much stronger cash management and commitment controls than in the past, as well as improvements in fiscal reporting to enhance budget execution.

40. As there is no room for fiscal slippage, concerted effort by the authorities and other domestic stakeholders to prepare for fiscal financing challenges is important. Domestic debt service is now eroding much-needed fiscal space, compromising already-limited delivery of public goods and services and ultimately the attainment of the Malawi Vision 2063, putting pressure on money growth, the exchange rate, and inflation. Concerted effort by the authorities and other domestic stakeholders will be required to address the fiscal financing challenges especially in the current environment where discussions to secure additional external sources (grants, concessional loans, external debt relief) are already exhaustively accounted for to execute the budget as passed.

41. Price stability supported by fiscal consolidation is critical to prevent a further erosion of purchasing power for those living in poverty and food insecurity. The RBM needs to persist in its efforts to reduce inflation and anchor inflation expectations by containing reserve money growth, aligning the policy rate with inflation to ensure positive real costs of borrowing, and raising required reserves if needed. The RBM should also remain vigilant to safeguard financial sector stability, given the banking sector's large exposures to government and associated potential risks.

42. Rebuilding buffers is critically important to reduce Malawi's vulnerability to external shocks. The RBM's commitment to rebuild its foreign exchange reserves requires implementation of its strategy to wind down unsustainable policies, including excessive use of swaps and sales of foreign exchange to support strategic imports in the absence of trade credit. Quickly rebuilding the RBM's foreign exchange reserve assets will be critical to restoring the normal functioning of trade credit and the steady supply of essential commodities in the country with little foreign exchange intervention by the RBM. This process should coincide with steps to promote price discovery and eliminate misalignment of the exchange rate.

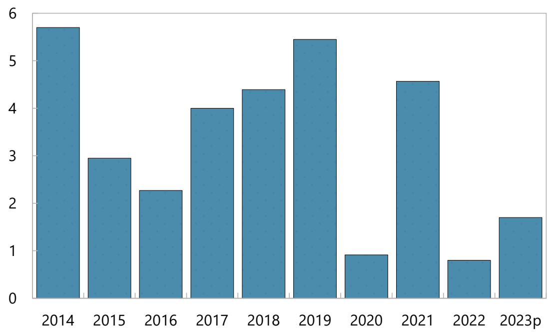
43. Addressing weakness in governance and institutions should be important priorities. The authorities should press ahead with implementation of their anti-corruption agenda, document progress on recent audits, and publish and reconcile strategic import data.

44. In the light of the above, staff assesses that the program remains on track to achieve its objectives.

Figure 1. Malawi: Real Sector Developments, 2010–23

Real GDP growth projection for 2023 was revised down from 2.4 percent (PMB approval) to 1.7 percent to reflect the impact of Cyclone Freddy.

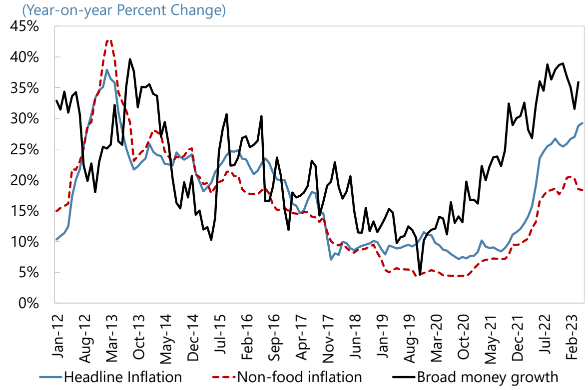
Real GDP Growth, 2014-23
(Percent)



Sources: Malawi authorities and IMF staff calculations

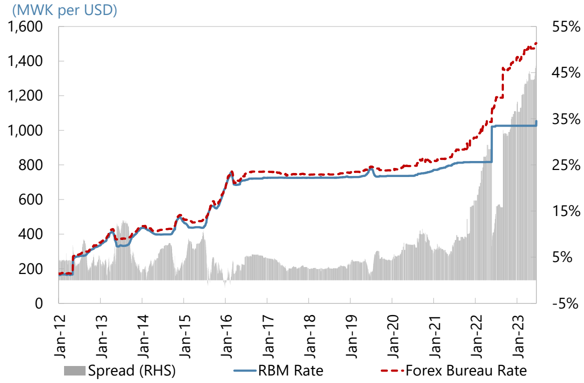
Inflationary pressures are showing signs of easing—consistent with developments in broad money growth.

Inflation and Broad Money Growth
(Year-on-year Percent Change)



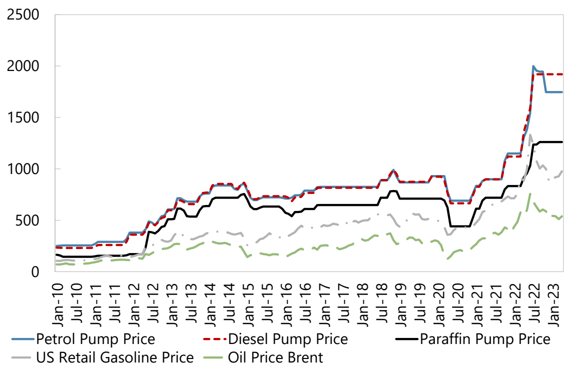
Pressure on the exchange rate remains high with the spread between the Forex bureau rate and the RBM rate at 44 percent at end-May 2023.

Daily Exchange Rates, Jan 2012 - June 21, 2023
(MWK per USD)



Despite falling international crude oil prices since July 2022 pump prices have not been adjusted since September 2022.

Pump Prices and Crude Oil Price, Jan 2010 - Apr 2023
(MWK per liter)

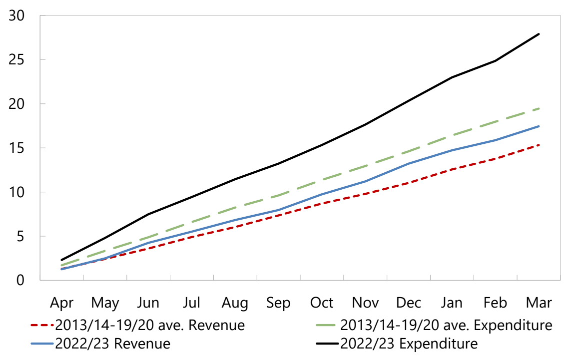


Sources: Reserve Bank of Malawi, Ministry of Finance, Malawi Energy Regulatory Authority, US EIA, and IMF staff estimates.

Figure 2. Malawi: Fiscal Sector Developments, 2005–24

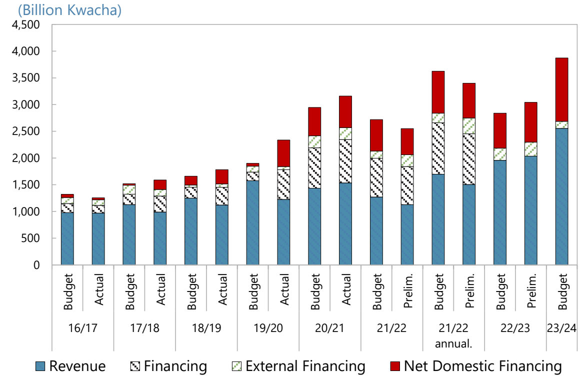
Revenue in FY2022/23 was higher than in the past but expenditure was substantially higher partly because of growing interest payments....

Revenue and Expenditure, 2013-23
(Percent of GDP)



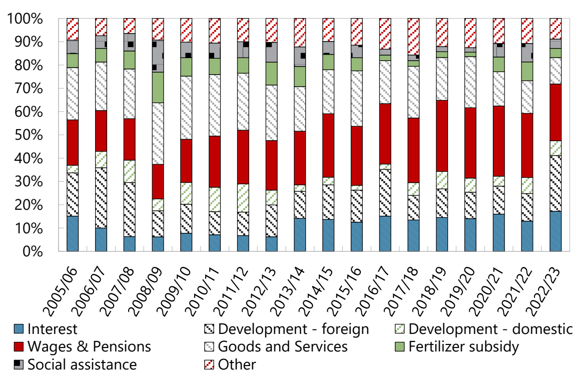
The rising domestic debt service is the result of growing domestic debt due to overly optimistic revenue projections and lack of commitment control over the years....

Budget versus Outturn, 2016-24
(Billion Kwacha)



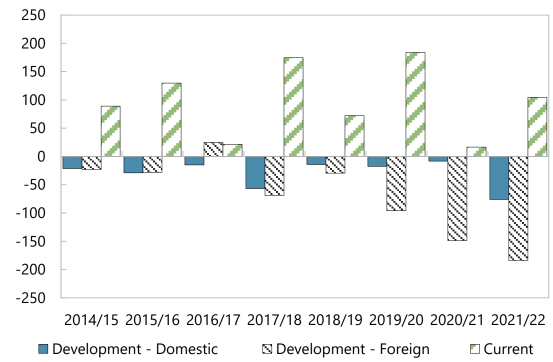
Interest payments and other recurrent spending have increased, crowding out social spending....

Composition of Expenditure



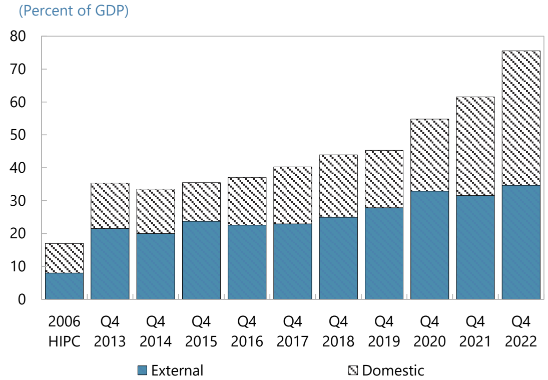
... while capital spending has been under executed.

Difference between Execution and Budgeted
(MWK Billion)



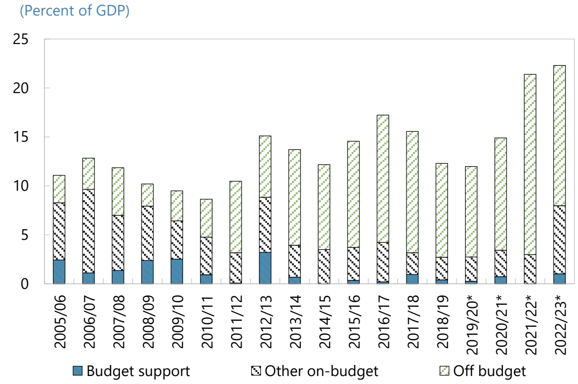
Public debt has reached historically high levels and the debt restructuring process is on-going...

Public Debt, 2006-22
(Percent of GDP)



Meanwhile, official aid came in strong (with higher share of on-budget support) to help Malawi weather this dire economic situation.

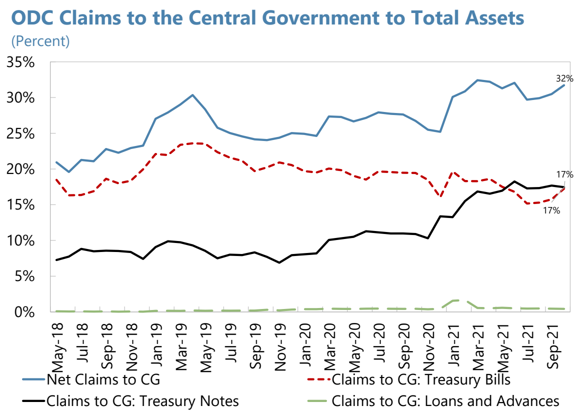
Official Development Assistance, 2005-23
(Percent of GDP)



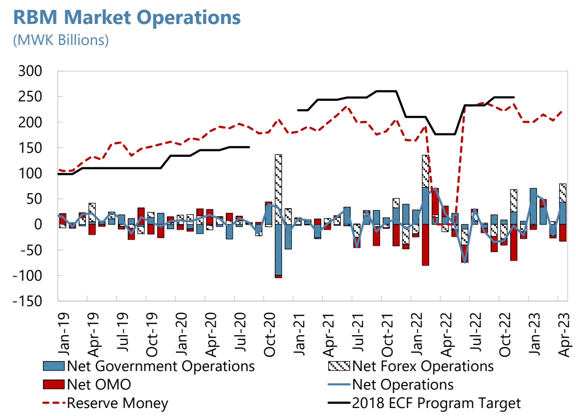
Sources: Malawi Ministry of Finance, OECD Creditor Reporting System, and IMF staff calculations.

Figure 3. Malawi: Monetary and Financial Sector Developments, 2012–23

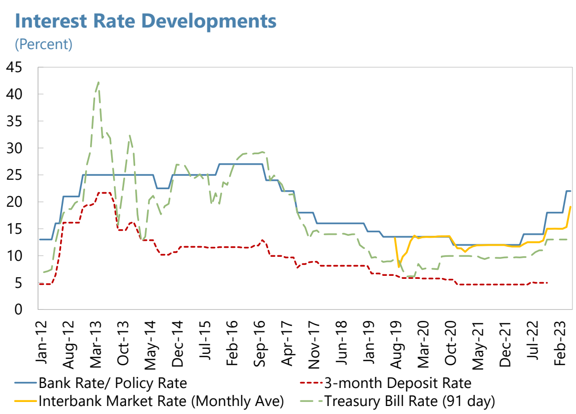
The implementation of the FY23/24 budget is predicated on other depository corporations (ODCs) buying more securities, but ODCs are already highly exposed to the central government (CG).



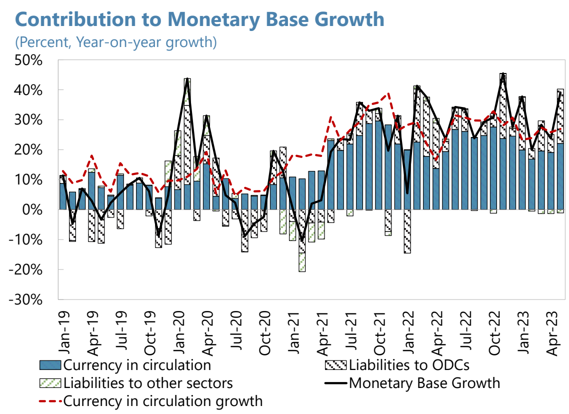
Moreover, sovereign security issuances since 2020 are accompanied by RBM's liquidity injection via open market operations, leading to a rapid increase in monetary base.



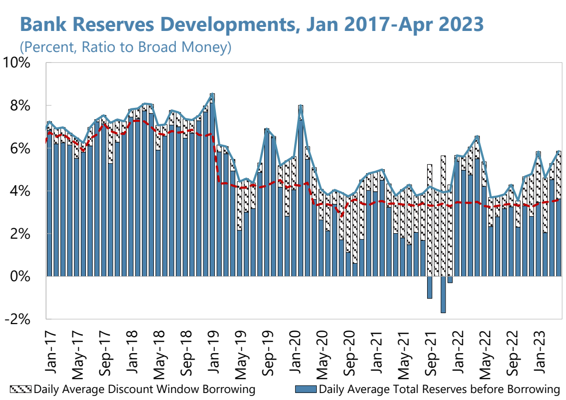
The RBM has been raising the monetary policy rate since May 2022, from 12 percent to 22 percent in May 2023 but the deposit rate has remained at below 5 percent…



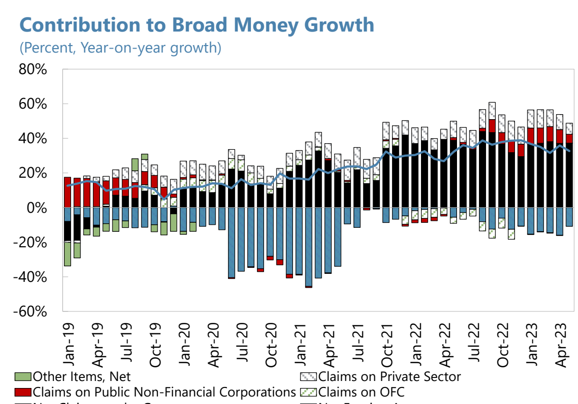
… leaving bank deposits / savings to lose value and currency in circulation stay high.



Banks are meeting prudential regulations, but liquidity has been at times inadequate…



Broad money growth is dominated by growth in net claims to CG, which more than offsets contraction in net foreign assets.

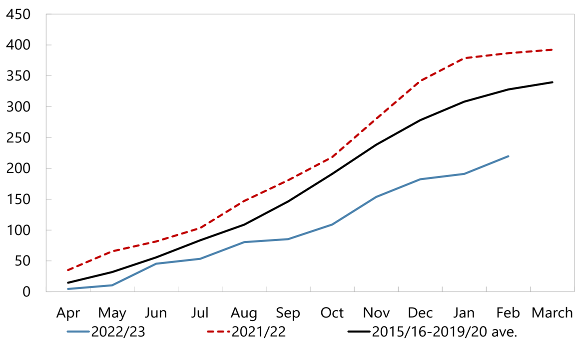


Sources: Reserve Bank of Malawi and IMF staff calculations.

Figure 4. Malawi: External Sector Developments, 2010–23

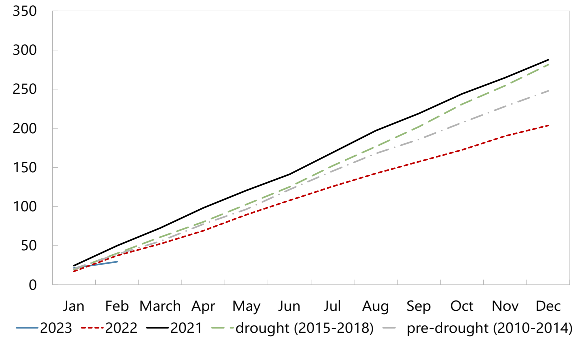
Scarce foreign exchange reserves have been diverted to secure strategic imports. Fertilizer imports were however notably lower in 2022/23 season and failed to peak at the planting season...

Cumulative Monthly Fertilizer Import Volume
(Million Kilograms)



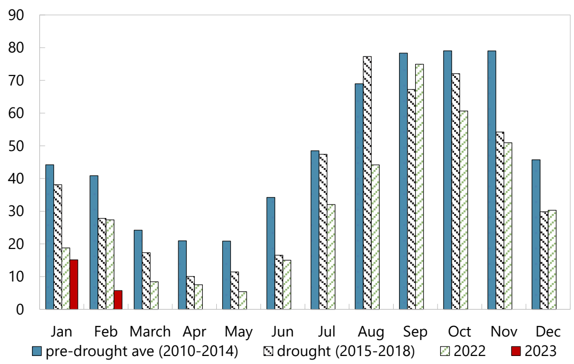
... while fuel imports have also been squeezed in the face of higher prices and foreign exchange shortages, according to the official customs data.

Cumulative Monthly Fuel Import Volume
(Million Liters)



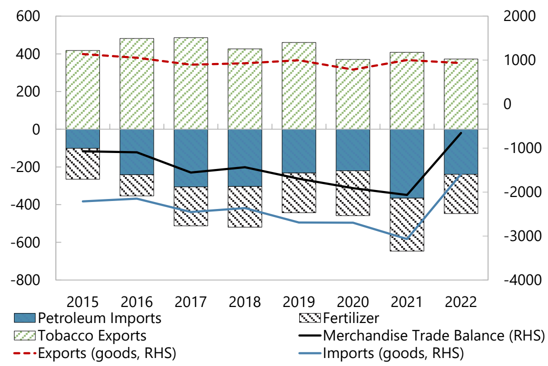
Tobacco exports remain an important source of foreign exchange and are expected to rebound in the coming months given crops were largely unaffected by Cyclone Freddy.

Monthly Tobacco Exports
(Million USD)



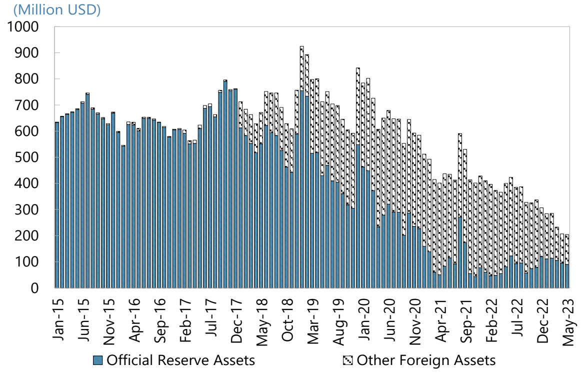
The merchandise trade deficit contracted sharply in 2022, largely reflecting a reported squeeze on other imports.

Exports and Imports, 2015-22
(Million USD)



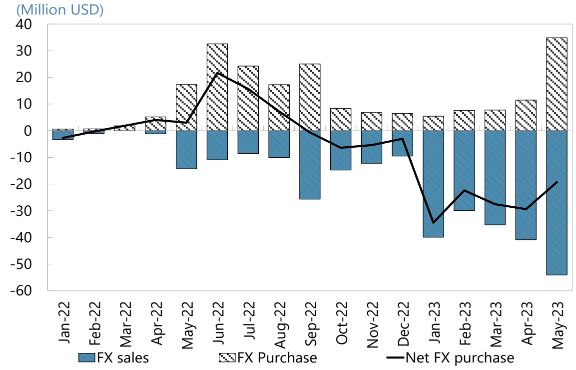
As foreign assets (in particular reserve assets) of the RBM declined,...

Foreign Assets, 2015-2023
(Million USD)



... trade credit dried out and RBM's net forex sales increased, leading to a further decline in reserve assets.

Malawi: Net FX Purchase, 2022-23
(Million USD)



Sources: Reserve Bank of Malawi, National Statistics Office of Malawi, and IMF staff calculations.

Table 1. Malawi: Selected Economic Indicators, 2021–28

	2021	2022		2023		2024	2025	2026	2027	2028
	Actual	PMB Approval	Est.	PMB Approval	Proj.	Proj.				
National accounts and prices (percent change, unless otherwise indicated)										
GDP at constant market prices	4.6	0.8	0.8	2.4	1.7	3.3	3.8	4.3	4.5	4.6
Nominal GDP (billions of Kwacha)	9,976	11,354	11,799	14,018	14,768	17,728	20,462	22,948	25,503	28,211
GDP deflator	8.2	17.3	17.3	20.6	23.1	16.3	11.2	7.5	6.3	5.8
Consumer prices (end of period)	11.5	26.0	25.4	20.4	24.4	15.2	9.9	7.6	6.5	6.5
Consumer prices (annual average)	9.3	20.8	20.8	22.7	24.8	18.3	12.2	8.1	6.8	6.5
Investment and savings (percent of GDP)										
National savings	-5.2	-4.8	9.9	-3.6	4.7	2.5	0.7	1.7	3.4	3.6
Government	-5.9	-5.1	-5.6	-7.8	-6.2	-6.4	-5.8	-4.6	-2.3	-1.3
Private	0.7	0.3	15.5	4.2	11.0	9.0	6.5	6.3	5.7	4.9
Gross investment	8.9	9.9	13.1	10.1	12.7	11.5	9.3	9.3	9.8	9.5
Government	6.4	6.9	10.2	7.3	9.9	8.7	6.2	5.8	5.5	5.4
Private	2.6	3.0	3.0	2.8	2.8	2.8	3.1	3.4	4.2	4.2
Saving-investment balance	-14.1	-14.8	-3.2	-13.6	-7.9	-9.0	-8.6	-7.6	-6.3	-5.9
Central government (percent of GDP on a fiscal year basis)[1, 2]										
Revenue	14.6	15.4	14.3	15.5	17.4	17.7	19.8	18.9	17.3	18.1
Tax and nontax revenue	12.9	13.4	12.5	13.9	13.5	14.9	17.5	17.2	15.9	17.0
Grants	1.7	1.9	1.8	1.6	3.9	2.7	2.3	1.6	1.4	1.1
Expenditure and net lending	21.9	24.3	22.6	24.6	29.3	27.5	27.8	25.4	23.6	23.1
Overall balance (excluding grants)	-9.1	-11.6	-10.8	-10.6	-15.8	-13.2	-11.7	-9.0	-7.8	-6.2
Overall balance (including grants)	-7.4	-9.7	-9.0	-9.0	-11.8	-10.5	-9.4	-7.3	-6.4	-5.0
Foreign financing	1.3	2.8	2.6	-0.6	3.3	0.6	0.0	-0.1	-0.4	-0.2
Total domestic financing	8.0	7.4	6.9	5.6	8.5	8.4	8.6	6.4	6.6	5.3
Financing gap/residual gap	0.0	0.0	0.0	4.1	0.0	1.5	0.8	1.0	0.2	0.0
Discrepancy	-0.1	-0.8	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	-3.6	-5.4	-5.0	-3.3	-6.8	-4.9	-1.6	1.2	1.5	2.1
Domestic primary balance[3]	-2.5	-4.1	-3.8	-0.6	-3.8	-2.8	0.5	2.9	2.8	3.1
Money and credit (change in percent of broad money at the end of the period, unless otherwise indicated)										
Broad money	30.0	27.5	38.8	23.5	25.2	20.0	15.4	12.2	11.1	10.6
Net foreign assets	-3.9	42.1	-13.8	19.1	-5.3	8.4	2.8	7.2	4.4	6.3
Net domestic assets	33.9	-14.6	52.6	4.3	30.5	11.7	12.6	5.0	6.7	4.3
o/w Net claims on the government	41.0	28.0	39.0	26.0	26.1	18.8	10.6	14.3	10.5	15.3
Credit to the private sector (percent change)	22.2	27.9	24.1	14.7	16.0	8.2	5.1	8.6	8.8	10.4
External sector (US$ millions, unless otherwise indicated)										
Exports (goods and services)	1,191	1,294	1,125	1,421	1,322	1,454	1,568	1,662	1,814	1,940
Imports (goods and services)	3,332	3,406	1,835	3,173	2,487	2,608	2,700	2,744	2,818	2,936
Gross official reserves[4]	429	172	120	409	499	747	846	996	1,106	1,202
(months of imports)	1.6	0.6	0.6	1.5	2.3	3.3	3.7	4.2	4.5	4.7
Net international reserves[5]	-834.8	-584.1	-1,237.9	-312.2	-673.1	-594.4	-575.9	-438.7	-321.4	-156.3
Current account (percent of GDP)	-14.1	-14.8	-3.2	-13.6	-7.9	-9.0	-8.6	-7.6	-6.3	-5.9
Current account, excl. official transfers (percent of GDP)	-14.1	-14.8	-3.8	-13.6	-7.9	-8.9	-8.6	-7.5	-6.3	-5.9
Current account, excl. project related imports (percent of GDP)	-12.0	-12.3	0.2	-10.8	-4.3	-5.8	-6.3	-5.7	-4.9	-4.3
Real effective exchange rate (percent change)	-5.7	...	2.9	...	...	...	...	...	...	...
Overall balance (percent of GDP)	0.0	-1.7	-0.1	-2.4	-2.6	0.1	-0.2	0.0	0.6	1.2
Financing gap (percent of GDP)	0.0	2.8	0.0	4.9	5.8	2.6	1.6	1.9	0.8	0.1
Terms of trade (percent change)	-19.0	-14.9	-14.3	-0.5	11.4	-1.8	1.8	2.2	2.1	-0.9
Debt stock and service (percent of GDP, unless otherwise indicated)										
External debt (public sector)	31.5	38.9	34.4	37.1	37.1	35.3	33.5	30.9	28.8	27.0
NPV of public external debt (percent of exports)	218.6	202.3	264.7	176.6	187.1	162.3	145.9	132.3	119.3	110.1
Domestic public debt[6]	30.0	37.7	40.8	37.5	43.2	44.9	47.4	48.6	49.3	48.1
Total public debt[6]	61.5	76.6	75.2	74.6	80.2	80.2	80.9	79.6	78.1	75.1
External debt service (percent of exports)	15.2	55.6	12.0	26.7	59.8	25.2	20.1	18.3	12.9	10.6
External debt service (percent of revenue excl. grants)	4.9	43.2	7.8	24.6	44.7	23.6	18.7	17.0	11.6	9.4

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

[1] The financial year, 2021, runs from July 1, 2020 to June 30, 2021. FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year.
starting from FY2022/23.

[2] Please note that government fiscal statistics are reported following the Government Finance Statistics Manual (2014) starting 2020 projections and going forward.

[3] Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and nontax revenues.

[4] Gross official reserves figures include encumbered deposits in 2021; all figures from 2022 onwards do not include encumbered deposits. Readily available gross official reserves were US$71.7

[5] 2021 NIR is calculated as gross official reserves minus a sum of Use of Fund Credit, repayments projection of medium-term debt by remaining maturity, and short-term swap outstanding. 2022 NIR is calculated as define in the TMU at the time of the PMB application. Thereafter, the net international reserves reported not only subtract foreign currency drains (FCD) as defined in the TMU of the First Review of the PMB, but also all outstanding foreign currency debt service to external creditors to which the RBM (including as an agent of the government) is in arrears and or servicing via other means, in line with debt restructuring strategy.

[6] Domestic debt is at face value and future borrowings is at cost value.

Table 2a. Malawi: Central Government Operations, FY 2020/21–27/28[1]

(Billions of Kwacha)

	2020/21	2021/22	2022/23		2023/24		2024/25	2025/26	2026/27	2027/28
	Actual	Prel.	PMB Approval	Est.	PMB Approval	Proj.		Proj.		
REVENUE	1,363.8	1,186.5	1,845.4	2,187.3	2,474.2	2,643.0	3,381.9	3,804.3	4,059.4	4,738.0
Taxes	1,136.0	978.3	1,561.3	1,598.2	2,050.1	2,028.6	2,541.4	3,107.7	3,522.9	4,228.7
Taxes on income profits and capital gains	539.9	451.3	717.5	749.2	916.7	955.5	1,221.5	1,532.0	1,739.6	2,225.5
Taxes on goods and services	502.7	439.1	696.5	691.4	951.3	871.6	1,059.3	1,262.3	1,427.4	1,602.2
Taxes on international trade and transaction	92.5	86.8	145.7	156.3	180.1	199.9	258.7	311.3	353.4	398.2
Other taxes	0.9	1.1	1.7	1.3	2.1	1.5	1.9	2.2	2.5	2.8
Grants	157.9	149.8	189.7	494.5	311.1	422.1	420.4	347.9	331.8	298.7
Current	16.0	0.0	0.0	35.9	0.0	0.0	0.0	0.0	0.0	0.0
Capital	141.9	149.8	189.7	440.4	311.1	422.1	420.4	347.9	331.8	298.7
Project grants	116.7	123.2	142.2	362.3	242.5	353.5	346.7	274.1	250.7	209.4
Dedicated Grants	25.2	26.6	47.4	78.2	68.6	68.6	73.7	73.8	81.1	89.3
Other Revenue	69.9	58.5	94.4	94.6	113.0	192.3	420.2	348.8	204.7	210.6
EXPENDITURE	2,049.7	1,920.6	2,921.7	3,671.8	3,696.1	4,267.7	5,113.5	5,346.9	5,567.6	6,049.8
EXPENSE	1,695.6	1,530.5	2,291.5	2,569.6	2,868.7	3,286.3	4,036.0	4,455.2	4,568.3	4,986.9
Compensation of employees	552.9	496.4	767.5	772.4	898.7	927.0	1,053.2	1,110.8	1,124.2	1,367.2
Purchase of goods and services	329.6	310.9	368.3	425.0	442.4	547.6	582.6	662.1	650.0	776.9
Interest	348.3	271.2	688.5	627.0	976.2	867.9	1,431.2	1,802.5	1,873.0	1,852.4
To non-residents	17.7	12.6	73.1	38.7	74.0	50.4	44.7	45.9	28.5	41.5
To residents other than general government	330.6	258.5	615.4	588.3	902.2	817.5	1,386.5	1,756.6	1,844.5	1,810.9
Grants	191.2	172.7	260.0	468.0	308.5	678.6	661.2	519.6	520.3	548.1
Current	168.9	157.2	220.5	255.2	262.8	286.6	333.4	378.3	424.6	480.9
Road fund Administration	32.9	37.6	44.5	66.2	54.4	78.5	93.1	106.7	119.3	132.4
Transfers to MRA	31.5	30.6	45.6	45.7	61.5	62.8	76.2	93.2	105.7	126.9
Transfers to public entities	104.4	89.1	130.5	131.3	146.9	145.4	164.0	178.4	199.6	221.6
Capital	22.3	15.5	39.5	212.8	45.7	392.0	327.8	141.2	95.7	67.3
Rural electrification programme	13.3	6.5	27.5	37.8	33.7	31.5	31.5	31.5	31.5	31.5
Net Lending	9.0	9.0	12.0	12.0	12.0	16.0	16.0	16.0	16.0	16.0
RBM				175.0		348.5	284.3	97.8	52.2	23.8
Social Benefits	244.4	248.8	192.4	262.3	233.8	248.8	288.3	337.8	375.7	414.5
Social assistance benefits	141.2	171.1	76.2	146.3	98.7	112.6	131.5	163.6	180.9	198.2
Fertiliser payments	121.1	156.6	69.8	144.2	88.5	103.3	92.3	99.4	111.3	123.5
Maize seed subsidy	17.0	12.3	4.4	0.2	7.7	6.6	8.4	9.2	10.3	11.4
Social Cash Transfer-Government	3.0	2.3	2.0	2.0	2.4	2.8	30.8	55.0	59.3	63.3
Pensions and gratuities	103.3	77.7	116.3	116.0	135.2	136.1	156.8	174.2	194.8	216.3
Other Expenses	29.2	30.5	14.7	14.9	9.0	16.5	19.6	22.4	25.1	27.8
Acquisition of Non-Financial Assets (Development Expenditure)	354.1	390.1	630.2	1,102.2	827.4	981.4	1,077.4	891.7	999.3	1,062.9
Foreign (Part I)	261.6	246.7	507.5	872.6	680.3	750.7	809.0	703.5	621.2	565.5
Domestic (Part II)	92.6	143.4	122.7	229.6	147.2	230.8	268.5	188.2	378.2	497.4
Discrepancy	-4.8	-58.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (incl. grants and discrepancy)	-690.7	-792.1	-1,076.3	-1,484.4	-1,221.9	-1,624.8	-1,731.5	-1,542.6	-1,508.2	-1,311.8
Primary Balance	-337.6	-462.9	-387.8	-857.5	-245.6	-756.9	-300.3	260.0	364.8	540.6
Domestic Primary Balance[2]	-233.9	-366.0	-70.0	-479.4	123.5	-428.3	88.3	615.6	654.2	807.3
NET FINANCING (Repayment if negative)	690.7	792.1	1,076.3	1,484.4	1,221.9	1,624.8	1,731.5	1,542.6	1,508.2	1,311.8
Net Incurrence of Liabilities	759.6	844.5	1,076.3	1,484.4	1,221.9	1,624.8	1,731.5	1,542.6	1,508.2	1,311.8
Total Financing	759.6	844.5	594.1	1,484.4	570.3	1,393.4	1,576.2	1,334.9	1,471.4	1,311.8
Foreign financing (net)	119.8	213.9	-68.8	416.0	22.1	89.3	-3.8	-13.8	-95.5	-63.9
Loans	119.8	213.9	-68.8	416.0	22.1	89.3	-3.8	-13.8	-95.5	-63.9
Programme Borrowing	51.7	0.0	0.0	90.7	0.0	0.0	0.0	0.0	0.0	0.0
Project Loans	110.1	96.9	363.6	413.9	369.1	328.6	388.6	355.7	289.4	266.8
Amortisation	-42.0	-34.8	-432.4	-88.5	-347.0	-239.3	-392.4	-369.4	-384.8	-330.7
Domestic financing (net)	749.3	569.6	662.9	1,068.3	548.2	1,304.1	1,580.1	1,348.7	1,566.8	1,375.8
Currency and deposits	0.0	0.0	0.0	0.0	0.0	60.6	0.0	0.0	0.0	0.0
Debt Instruments	637.3	630.6	…	920.0	…	1,044.5	1,136.3	861.5	1,085.7	817.5
Banking system borrowing	…	…	…	684.6	…	727.5	678.6	535.5	722.4	595.7
RBM[3]	…	…	…	285.7	…	253.5	23.1	-74.0	41.0	23.8
Commercial banks	…	…	…	398.9	…	474.0	655.5	609.5	681.4	571.9
Nonbank sector borrowing	…	…	…	235.4	…	317.0	457.7	326.0	363.3	221.7
Amortization	0.0	90.3	-1,017.6	-71.6	-1,371.4	-2,901.9	-1,681.6	-1,507.6	-1,800.5	-1,800.5
Change in accounts payable (+ increase / - decrease in arrears)	0.0	0.0	0.0	148.3		199.1	443.8	487.2	481.1	558.3
Financing Gap[4]			482.2	0.0	651.6	231.4	155.3	207.7	36.8	0.0
Concessional budget support loans (prospective)			…	…	…	14.8	18.0	20.3	21.7	0.0
Concessional budget support grants (prospective)			…	0.0	…	216.6	137.3	187.4	15.2	0.0
Memorandum items:										
Nominal GDP (fiscal year)	9,354.8	8,290.0	11,901.6	12,541.1	14,565.9	15,508.3	18,411.4	21,083.7	23,587.2	26,180.2

Sources: Malawi Ministry of Finance; and IMF staff projections.

[1] FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year starting from FY2022/23

[2] Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and non-tax revenues.

[3] RBM financing reported here include those flows related to recapitalization of the RBM.

[4] The remaining financing gap would be filled by prospective concessional support and exceptional financing.

Table 2b. Malawi: Central Government Operations, FY 2020/21–27/28[1]

(Percent of GDP)

	2020/21	2021/22	2022/23		2023/24		2024/25	2025/26	2026/27	2027/28
	Actual	Prel.	PMB Approval	Est.	PMB Approval	Proj.	Proj.			
REVENUE	14.6	14.3	15.5	17.4	17.0	17.7	19.8	18.9	17.3	18.1
Taxes	12.1	11.8	13.1	12.7	14.1	13.1	13.8	14.7	14.9	16.2
Taxes on income profits and capital gains	5.8	5.4	6.0	6.0	6.3	6.2	6.6	7.3	7.4	8.5
Taxes on goods and services	5.4	5.3	5.9	5.5	6.5	5.6	5.8	6.0	6.1	6.1
Taxes on international trade and transaction	1.0	1.0	1.2	1.2	1.2	1.3	1.4	1.5	1.5	1.5
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	1.7	1.8	1.6	3.9	2.1	2.7	2.3	1.6	1.4	1.1
Current	0.2	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Capital	1.5	1.8	1.6	3.5	2.1	2.7	2.3	1.6	1.4	1.1
Project grants	1.2	1.5	1.2	2.9	1.7	2.3	1.9	1.3	1.1	0.8
Dedicated Grants	0.3	0.3	0.4	0.6	0.5	0.4	0.4	0.3	0.3	0.3
Other Revenue	0.7	0.7	0.8	0.8	0.8	1.9	3.7	2.5	0.9	0.8
EXPENDITURE	21.9	22.6	24.6	29.3	25.8	27.5	27.8	25.4	23.6	23.1
EXPENSE	18.1	17.9	19.3	20.5	20.1	21.2	21.9	21.1	19.4	19.0
Compensation of employees	5.9	6.0	6.4	6.2	6.2	6.0	5.7	5.3	4.8	5.2
Purchase of goods and services	3.5	3.7	3.1	3.4	3.0	3.5	3.2	3.1	2.8	3.0
Interest	3.7	3.3	5.9	5.0	7.1	5.6	7.8	8.5	7.9	7.1
To non-residents	0.2	0.2	0.6	0.3	0.5	0.3	0.2	0.2	0.1	0.2
To residents other than general government	3.5	3.1	5.2	4.7	6.6	5.3	7.5	8.3	7.8	6.9
Grants	2.0	2.1	2.2	3.7	2.1	4.4	3.6	2.5	2.2	2.1
Current	1.8	1.9	1.9	2.0	1.8	1.8	1.8	1.8	1.8	1.8
Road fund Administration	0.4	0.5	0.4	0.5	0.4	0.5	0.5	0.5	0.5	0.5
Transfers to MRA	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5
Transfers to public entities	1.1	1.1	1.1	1.0	1.0	0.9	0.9	0.8	0.8	0.8
Capital	0.2	0.2	0.3	1.7	0.3	2.5	1.8	0.7	0.4	0.3
Rural electrification programme	0.1	0.1	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Transfers to NRA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Lending	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
RBM				1.4		2.2	1.5	0.5	0.2	0.1
Social Benefits	2.6	2.5	1.6	2.1	1.6	1.6	1.6	1.6	1.6	1.6
Social assistance benefits	1.5	1.6	0.6	1.2	0.7	0.7	0.7	0.8	0.8	0.8
Fertiliser payments	1.3	1.4	0.6	1.1	0.6	0.7	0.5	0.5	0.5	0.5
Maize seed subsidy	0.2	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Social Cash Transfer-Government	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.3	0.3	0.2
Pensions and gratuities	1.1	0.9	1.0	0.9	0.9	0.9	0.9	0.8	0.8	0.8
Other Expenses	0.3	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Acquisition of Non-Financial Assets (Development Expenditure)	3.8	4.7	5.3	8.8	5.7	6.3	5.9	4.2	4.2	4.1
Foreign (Part I)	2.8	3.0	4.3	7.0	4.7	4.8	4.4	3.3	2.6	2.2
Domestic (Part II)	1.0	1.7	1.0	1.8	1.0	1.5	1.5	0.9	1.6	1.9
Discrepancy	-0.1	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (incl. grants and discrepancy)	-7.4	-9.0	-9.0	-11.8	-8.4	-10.5	-9.4	-7.3	-6.4	-5.0
Primary Balance	-3.6	-5.0	-3.3	-6.8	-1.7	-4.9	-1.6	1.2	1.5	2.1
Domestic Primary Balance[2]	-2.5	-3.8	-0.6	-3.8	0.8	-2.8	0.5	2.9	2.8	3.1
NET FINANCING (Repayment if negative)	7.4	9.6	9.0	11.8	8.4	10.5	9.4	7.3	6.4	5.0
Net Incurrence of Liabilities	8.1	10.2	9.0	11.8	8.4	10.5	9.4	7.3	6.4	5.0
Total Financing	8.1	10.2	5.0	11.8	3.9	9.0	8.6	6.3	6.2	5.0
Foreign financing (net)	1.3	2.6	-0.6	3.3	0.2	0.6	0.0	-0.1	-0.4	-0.2
Loans	1.3	2.6	-0.6	3.3	0.2	0.6	0.0	-0.1	-0.4	-0.2
Programme Borrowing	0.6	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Project Loans	1.2	1.2	3.1	3.3	2.5	2.1	2.1	1.7	1.2	1.0
Amortisation	-0.4	-0.4	-3.6	-0.7	-2.4	-1.5	-2.1	-1.8	-1.6	-1.3
Domestic financing (net)	8.0	6.9	-3.6	8.5	-2.4	8.4	8.6	6.4	6.6	5.3
Currency and deposits	0.0	0.0	...	0.0	...	0.4	0.0	0.0	0.0	0.0
Debt Instruments	6.8	7.6	...	7.3	...	6.7	6.2	4.1	4.6	3.1
Banking system borrowing	...	...	...	5.5	...	4.7	3.7	2.5	3.1	2.3
RBM[3]	...	...	...	2.3	...	1.6	0.1	-0.4	0.2	0.1
Commercial banks	...	...	...	3.2	...	3.1	3.6	2.9	2.9	2.2
Nonbank sector borrowing	...	...	...	1.9	...	2.0	2.5	1.5	1.5	0.8
Amortization	0.0	1.1	...	-0.6	...	-18.7	-9.1	-7.2	-7.6	-6.9
Change in accounts payable (+ increase / - decrease in arrears)	...	...	...	1.2	...	1.3	2.4	2.3	2.0	2.1
Financing Gap[4]			4.1	0.0	4.5	1.5	0.8	1.0	0.2	0.0
Concessional budget support loans (prospective)			...	...	...	0.1	0.1	0.1	0.1	0.0
Concessional budget support grants (prospective)			...	0.0	...	1.4	0.7	0.9	0.1	0.0

Sources: Malawi Ministry of Finance; and IMF staff projections.

[1] FY2021/22 covers 1 July 2021 to 31 March 2022, to accommodate the transition to an April - March fiscal year starting from FY2022/23.

[2] Domestic primary balance is calculated by subtracting current expenditures (except interest payment) and domestically-financed development expenditures from tax and nontax revenues.

[3] RBM financing reported here include those flows related to recapitalization of the RBM.

[4] The remaining financing gap would be filled by prospective concessional support and exceptional financing.

Table 3a. Malawi: Central Bank Survey, 2021–28

(Billions of Kwacha, Unless Otherwise Indicated)

	2021	2022				2023				2024	2025	2026	2027	2028
	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.					
	Actual	Actual				Proj.				Proj.				
Monetary base	449	438	538	542	571	562	615	666	719	863	996	1,117	1,241	1,373
Currency in circulation	359	313	448	453	470	399	...	...	...	...	...	...	...	...
Liabilities to other depository corporations	89	117	87	87	101	161	...	...	...	...	...	...	...	...
Liabilities to other sectors	1	7	2	2	1	1	...	...	...	...	...	...	...	...
Net foreign assets (NFA) [1]	-569	-619	-673	-841	-955	-1,025	-919	-1,109	-1,183	-904	-788	-470	-254	107
Claims on nonresidents	361	307	438	336	318	241	...	...	...	...	...	...	...	...
Official reserve assets	73	39	127	58	124	96	...	...	...	...	...	...	...	...
Other foreign assets	287	268	310	278	193	303	...	...	...	...	...	...	...	...
Liabiliites to nonresidents	-930	-926	-1,110	-1,176	-1,273	-1,266	...	...	...	...	...	...	...	...
Short -term foreign liabilities	-298	-296	-348	-330	-424	-341	...	...	...	...	...	...	...	...
Other foreign liabilities	-631	-630	-763	-847	-849	-766	...	...	...	...	...	...	...	...
Net domestic assets	1,018	1,057	1,210	1,383	1,526	1,586	1,534	1,774	1,901	1,767	1,784	1,587	1,496	1,266
Net claims on central government	541	730	730	835	1,080	1,109	1,014	1,014	1,362	1,386	1,312	1,353	1,376	1,388
Claims on central government	3,671	4,176	4,551	4,650	5,207	5,408	...	...	...	...	...	...	...	...
Liabilities to central government	3,130	3,446	3,821	3,815	4,127	4,299	...	...	...	...	...	...	...	...
Claims on other depository corporations	33	34	34	119	95	102	108	114	120	126	132	138	144	149
Claims on other financial corporations	33	34	34	45	27	28	...	...	...	...	...	...	...	...
Claims on public nonfinancial corportions	146	143	170	278	323	333	...	...	...	...	...	...	...	...
Claims on private sector	25	26	28	30	31	34	...	...	...	...	...	...	...	...
Other items (net)	239	89	215	77	-31	-19	...	...	...	...	...	...	...	...
Memorandum items:														
Money multiplier	4.5	4.7	4.4	4.6	4.9	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Annual growth of reserve money (percent)	31.3	37.6	34.2	29.3	27.0	28.3	14.4	22.8	25.9	20.0	15.4	12.2	11.1	10.6
91-day treasury bill rate	9.6	9.7	9.7	9.8	11.0	13.0	13.0	...	...	...	...	...	...	...

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

[1] Including SDR allocation and the entire assets and liabilities of the RBM.

Table 3b. Malawi: Depository Corporations Survey, 2021–28

(Billions of Kwacha, Unless Otherwise Indicated)

	2021	2022				2023				2024	2025	2026	2027	2028
	Dec.	Mar.	June.	Sept.	Dec.	Mar.	June.	Sept.	Dec.					
	Actual	Actual				Proj.				Proj.				
Broad money liabilities	2,004	2,058	2,372	2,477	2,782	2,721	2,804	3,000	3,482	4,180	4,825	5,411	6,014	6,652
Currency outside depository corporations	300	270	393	313	448	453	...	...	...	...	...	...	...	...
Transferable deposits	918	1,001	1,147	1,186	1,366	1,292	...	...	...	...	...	...	...	...
Other deposits	0	0	0	0	0	0	...	...	...	...	...	...	...	...
Net foreign assets (NFA)	-406	-494	-489	-647	-683	-784	-659	-788	-832	-540	-423	-78	-20	541
Monetary authorities	-569	-619	-673	-841	-955	-1,025	-919	-1,109	-1,183	-904	-788	-470	-254	107
Gross foreign assets	361	307	438	336	318	241	...	...	...	...	...	...	...	...
Foreign liabilities	-930	-926	-1,110	-1,176	-1,273	-1,266	...	...	...	...	...	...	...	...
Commercial banks (net)	163	125	184	194	272	241	260	321	351	364	365	393	415	434
Net domestic assets (NDA)	2,410	2,552	2,861	3,124	3,466	3,505	3,462	3,787	4,314	4,721	5,248	5,489	5,853	6,111
Net claims on central government	1,609	1,747	1,824	1,983	2,390	2,537	2,554	2,664	3,116	3,771	4,215	4,906	5,472	6,394
Claims on central government	4,834	5,287	5,766	5,924	6,609	6,944	...	...	...	...	...	...	...	...
Liabilities to central government	3,226	3,540	3,942	3,940	4,219	4,406	...	...	...	...	...	...	...	...
Claims on other sectors	1,093	1,077	1,243	1,420	1,478	1,454	1,524	1,588	1,655	1,787	1,702	1,717	1,835	2,001
Claims on other financial corporations	55	60	57	68	52	57	60	63	66	73	73	73	73	73
Claims on public nonfinancial corporations	216	214	259	366	406	394	391	399	406	433	283	183	173	174
Claims on private sector	822	803	927	986	1,020	1,003	1,073	1,127	1,183	1,280	1,345	1,460	1,589	1,753
Other items (net)	-291	-271	-206	-279	-402	-486	-616	-465	-457	-837	-669	-1,134	-1,453	-2,284
Memorandum items:														
Velocity of money														
(annualized GDP divided by broad money)	5.0	5.3	4.7	4.7	4.2	4.9	4.7	4.7	4.2	4.2	4.2	4.2	4.2	4.2
Annual growth of broad money (percent)	30.0	27.5	36.0	36.3	38.8	32.2	18.2	21.1	25.2	20.0	15.4	12.2	11.1	10.6
Annual growth of credit to the private sector (percent)	22.2	18.9	23.2	22.3	24.1	24.9	15.7	14.3	16.0	8.2	5.1	8.6	8.8	10.4
Nominal GDP (billions of Kwacha)	9,976	11,799	11,799	11,799	11,799	14,768	14,768	14,768	14,768	17,728	20,462	22,948	25,503	28,211

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

Table 4a. Malawi: Balance of Payments, 2021–28

(Millions of U.S. Dollars, Unless Otherwise Indicated)

	2021		2022		2023	2024	2025	2026	2027	2028
	Actual	PMB Approval	Est.	PMB Approval	Est.			Proj.		
Current account balance	-1,763.2	-1,740.3	-400.4	-1,549.3	-1,023.7	-964.1	-944.9	-863.7	-763.4	-752.8
Merchandise trade balance	-2,065.7	-1,995.7	-655.1	-1,741.0	-1,163.9	-1,143.3	-1,117.0	-1,067.5	-956.6	-975.3
Exports	1,001.7	1,107.5	934.1	1,279.2	1,127.7	1,253.0	1,359.8	1,444.3	1,587.5	1,702.7
Of which: Tobacco	408.2	424.2	372.9	455.2	446.0	462.4	479.5	497.7	511.6	521.8
Imports	-3,067.4	-3,103.2	-1,589.2	-3,020.2	-2,291.6	-2,396.4	-2,476.8	-2,511.9	-2,544.1	-2,678.1
Of which: Petroleum products	-365.2	-270.7	-239.1	-284.7	-208.7	-196.6	-208.3	-221.7	-234.4	-243.9
Of which: Fertilizers	-281.3	-284.1	-208.3	-315.5	-223.7	-230.5	-237.5	-245.9	-255.2	-262.9
Of which: Project related	-266.2	-290.4	-421.8	-363.3	-467.7	-335.8	-247.3	-206.9	-170.2	-204.2
Services balance	-309.9	-407.5	-295.3	-328.3	-344.8	-291.6	-296.6	-275.1	-307.4	-301.2
Interest public sector	-38.7	-98.4	-42.9	-49.3	-143.2	-72.3	-65.9	-35.3	-24.4	-34.4
Other factor payments (net)	-195.7	-192.8	-197.5	-204.2	-201.1	-207.8	-215.9	-225.3	-235.6	-246.6
Nonfactor (net)	-75.5	-116.3	-54.9	-74.8	-0.5	-11.4	-14.9	-14.5	-47.3	-20.2
Unrequited transfers (net)	612.5	663.0	549.9	520.0	485.0	470.8	468.8	479.0	500.6	523.7
Private (net)	613.6	664.2	479.6	521.2	486.3	472.1	470.0	480.3	501.9	525.0
Official (net)	-1.1	-1.2	70.3	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Receipts	0.0	0.0	71.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	0.0	0.0	71.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments	-1.1	-1.2	-1.2	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Capital account balance	1,077.4	1,577.8	785.2	1,358.4	1,109.7	919.7	868.6	842.4	756.7	775.1
Project and dedicated grants	232.0	156.1	370.3	295.6	364.4	277.1	179.4	167.3	145.0	169.6
Off-budget project support[1]	845.4	1,421.7	414.9	1,062.8	745.3	642.6	689.2	675.1	611.7	605.5
Financial account balance	541.9	-39.1	-396.3	215.6	-420.9	58.9	49.0	24.1	83.4	136.3
Financial account balance	541.9	-39.1	-396.3	215.6	-420.9	58.9	49.0	24.1	83.4	136.3
Foreign direct investment (net)	96.6	94.3	37.1	126.9	53.2	56.7	93.2	97.8	112.8	129.1
Portfolio investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medium- and long-term loans (net)	233.9	-190.9	214.8	40.8	-233.5	-2.8	5.2	-38.9	-44.3	35.9
SDR allocation	190.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Disbursements	185.8	290.7	278.6	263.3	355.2	239.5	201.0	151.0	116.9	144.6
Budget support and other program loans	8.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project support loans	177.6	290.7	278.6	263.3	355.2	239.5	201.0	151.0	116.9	144.6
Other medium-term loans (official)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-141.9	-481.6	-63.8	-222.5	-588.7	-242.4	-195.8	-189.9	-161.3	-108.7
Other inflows	211.4	57.5	-648.1	47.9	-240.6	5.1	-49.4	-34.8	14.9	-28.7
Overall balance	-159.1	-201.6	-11.5	24.7	-334.9	14.6	-27.3	2.8	76.7	158.5
Financing	159.1	201.6	11.5	-24.7	334.9	-14.6	27.3	-2.8	-76.7	-158.5
Gross reserves (- increase)	159.1	-100.0	-48.5	-272.7	-378.3	-249.0	-98.7	-149.9	-110.4	-95.3
IMF (net)	0.0	-30.8	60.0	-35.1	-38.9	-40.7	-54.7	-74.2	-64.6	-79.3
Purchases/drawings	0.0		90.5		0.0	0.0	0.0	0.0	0.0	0.0
Repurchases/repayments	26.2	36.2	36.0	35.1	38.9	40.7	54.7	74.2	64.6	79.3
Exceptional financing (CCRT)	26.2	5.4	5.4							
Financing gap[2]		332.4	0.0	283.0	752.1	275.0	180.7	221.3	98.2	16.0
Concessional budget support loans (prospective)		0.0	0.0	39.2	35.2	17.6	35.2	35.2	52.8	0.0
Concessional budget support grants (prospective)		71.5	0.0	80.0	248.0	80.0	18.0	90.0	0.0	0.0
Other financing (prospective)		172.6	0.0	163.8	468.9	177.5	127.5	96.1	45.4	16.0
Memorandum items:										
Gross official reserves[3]	429.2	171.7	120.2	409.1	498.5	747.5	846.2	996.1	1,106.5	1,201.8
Months of imports[4]	1.6	0.6	0.6	1.5	2.3	3.3	3.7	4.2	4.5	4.7
Net international reserves[5]	-834.8	-584.1	-1,237.9	-312.2	-673.1	-594.4	-575.9	-438.7	-321.4	-156.3
Current account balance (percent of GDP)	-14.1	-14.8	-3.2	-13.6	-7.9	-9.0	-8.6	-7.6	-6.3	-5.9
Import price index (2005 = 100)	153.0	181.8	183.5	177.1	170.3	171.2	166.4	162.5	159.1	160.7
Import volume (percent change)	-12.4	-16.4	-56.8	-3.9	55.4	4.0	6.3	3.8	3.5	4.2
REER (percent change)	-5.7	...	2.9	...	...	...	...	...	...	...
Overall balance (percent of GDP)	0.0	-1.7	-0.1	-2.4	-2.6	0.1	-0.2	0.0	0.6	1.2
Terms of trade (percent change)	-19.0	-14.9	-14.3	-0.5	11.4	-1.8	1.8	2.2	2.1	-0.9

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

[1] Includes estimate for project grants not channeled through the budget.

[2] The remaining financing gap would be filled by prospective concessional support and exceptional financing.

[3] Gross official reserves figures include encumbered deposits in 2021; all figures from 2022 onwards do not include encumbered deposits. Readily available gross official reserves for 2021 were US$71.7 in 2021.

[4] In months of goods and nonfactor services in the following year.

[5] 2021 NIR is calculated as gross official reserves minus a sum of Use of Fund Credit, repayments projection of medium-term debt by remaining maturity, and short-term swap outstanding. 2022 NIR is calculated as define in the TMU at the time of the PMB application. Thereafter, the net international reserves reported not only subtract foreign currency drains (FCD) as defined in the TMU of the First Review of the PMB, but also all outstanding foreign currency debt service to external creditors to which the RBM (including as an agent of the government) is in arrears and or servicing via other means, in line with debt restructuring strategy.

Table 4b. Malawi: Balance of Payments, 2021–28

(Percent of GDP)

	2021	2022		2023		2024	2025	2026	2027	2028
	Prel.	PMB Approval	Est.	PMB Approval	Est.			Proj.		
Current account balance	-14.1	-14.8	-3.2	-13.6	-7.9	-9.0	-8.6	-7.6	-6.3	-5.9
Merchandise trade balance	-16.6	-16.9	-5.2	-15.9	-9.0	-10.6	-10.1	-9.3	-7.9	-7.7
Exports	8.0	9.4	7.5	11.6	8.7	11.6	12.3	12.6	13.2	13.4
Of which: Tobacco	3.3	3.6	3.0	4.1	3.5	4.3	4.4	4.4	4.3	4.1
Imports	-24.6	-26.3	-12.7	-27.4	-17.8	-22.3	-22.5	-22.0	-21.1	-21.1
Of which: Petroleum products	-2.9	-2.3	-1.9	-2.5	-1.6	-1.8	-1.9	-1.9	-1.9	-1.9
Of which: Fertilizers	-2.3	-2.4	-1.7	-2.9	-1.7	-2.1	-2.2	-2.2	-2.1	-2.1
Of which: Project related	-2.1	-2.5	-3.4	-2.8	-3.6	-3.1	-2.2	-1.8	-1.4	-1.6
Services balance	-2.5	-3.5	-2.4	-3.1	-2.7	-2.7	-2.7	-2.4	-2.6	-2.4
Interest public sector	-0.3	-0.8	-0.3	-0.5	-1.1	-0.7	-0.6	-0.3	-0.2	-0.3
Other factor payments (net)	-1.6	-1.6	-1.6	-1.9	-1.6	-1.9	-2.0	-2.0	-2.0	-1.9
Nonfactor (net)	-0.6	-1.0	-0.4	-0.6	0.0	-0.1	-0.1	-0.1	-0.4	-0.2
Unrequited transfers (net)	4.9	5.6	4.4	5.3	3.8	4.4	4.3	4.2	4.2	4.1
Private (net)	4.9	5.6	3.8	5.3	3.8	4.4	4.3	4.2	4.2	4.1
Official (net)	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account balance	8.6	13.4	6.3	9.7	8.6	8.5	7.9	7.4	6.3	6.1
Project and dedicated grants	1.9	1.3	3.0	1.8	2.8	2.6	1.6	1.5	1.2	1.3
Off-budget project support[1]	6.8	12.1	3.3	7.9	5.8	6.0	6.3	5.9	5.1	4.8
Financial account balance	4.3	-0.3	-3.2	1.5	-3.3	0.5	0.4	0.2	0.7	1.1
Foreign direct investment (net)	0.8	0.8	0.3	1.0	0.4	0.5	0.8	0.9	0.9	1.0
Portfolio investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	1.9	-1.6	1.7	0.1	-1.8	0.0	0.0	-0.3	-0.4	0.3
SDR allocation	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Disbursements	1.5	2.5	2.2	2.6	2.8	2.2	1.8	1.3	1.0	1.1
Budget support and other program loans	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project support	1.4	2.5	2.2	2.6	2.8	2.2	1.8	1.3	1.0	1.1
Other medium-term loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-1.1	-4.1	-0.5	-2.5	-4.6	-2.3	-1.8	-1.7	-1.3	-0.9
Other inflows	1.7	0.5	-5.2	0.4	-1.9	0.0	-0.4	-0.3	0.1	-0.2
Errors and omissions	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.3	-1.7	-0.1	-2.4	-2.6	0.1	-0.2	0.0	0.6	1.2
Financing	1.3	1.7	0.1	2.4	2.6	-0.1	0.2	0.0	-0.6	-1.2
Gross reserves (- increase)	1.3	-0.8	-0.4	-2.2	-2.9	-2.3	-0.9	-1.3	-0.9	-0.7
IMF (net)	0.0	-0.3	0.5	-0.3	-0.3	-0.4	-0.5	-0.6	-0.5	-0.6
Purchases/drawings	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases/repayments	0.2	0.3	0.3	0.3	0.3	0.4	0.5	0.6	0.5	0.6
Exceptional financing (CCRT)	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap[2]	0.0	2.8	0.0	4.9	5.8	2.6	1.6	1.9	0.8	0.1
Concessional budget support loans (prospective)				0.4	0.3	0.2	0.3	0.3	0.4	0.0
Concessional budget support grants (prospective)	0.0	0.6	0.0	2.4	1.9	0.7	0.2	0.8	0.0	0.0
Other financing (prospective)	0.0	1.5	0.0	2.1	3.6	1.6	1.2	0.8	0.4	0.1
Memorandum items:										
Gross official reserves[3]	3.4	1.5	1.0	3.9	3.9	6.9	7.7	8.7	9.2	9.5
Months of imports[4]	1.6	0.6	0.6	1.5	2.3	3.3	3.7	4.2	4.5	4.7
Net international reserves[5]	-6.7	-5.0	-9.9	-2.9	-5.2	-5.5	-5.2	-3.8	-2.7	-1.2
Current account balance (percent of GDP)	-14.1	-14.8	-3.2	-13.6	-7.9	-9.0	-8.6	-7.6	-6.3	-5.9
Import price index (2005 = 100)	153.0	181.8	183.5	177.6	170.3	171.2	166.4	162.5	159.1	160.7
Import volume (percent change)	-12.4	-16.4	-56.8	-3.9	55.4	4.0	6.3	3.8	3.5	4.2
REER (percent change)	-5.7	...	2.9	...	...	...	...	...	...	...
Overall balance (percent of GDP)	0.0	-1.7	-0.1	-2.4	-2.6	0.1	-0.2	0.0	0.6	1.2
Terms of trade (percent change)	-19.0	-14.9	-14.3	-0.5	11.4	-1.8	1.8	2.2	2.1	-0.9

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

[1] Includes estimate for project grants not channeled through the budget.

[2] The remaining financing gap would be filled by prospective concessional support and exceptional financing.

[3] Gross official reserves figures include encumbered deposits in 2021; all figures from 2022 onwards do not include encumbered deposits. Readily available gross official reserves for 2021 were US$71.7 in 2021.

[4] In months of goods and nonfactor services in the following year.

[5] 2021 NIR is calculated as gross official reserves minus a sum of Use of Fund Credit, repayments projection of medium-term debt by remaining maturity, and short-term swap outstanding. 2022 NIR is calculated as define in the TMU at the time of the PMB application. Thereafter, the net international reserves reported not only subtract foreign currency drains (FCD) as defined in the TMU of the First Review of the PMB, but also all outstanding foreign currency debt service to external creditors to which the RBM (including as an agent of the government) is in arrears and or servicing via other means, in line with debt restructuring strategy.

Table 5. Malawi: Selected Banking Soundness Indicators, 2019–23
(Percent of GDP)

Key ratios	Dec-19	Dec-20	Dec-21	Dec-22	May-23
Capital Adequacy					
1. Regulatory Tier 1 capital to risk weighted assets	17.0	17.4	17.2	17.7	21.6
2. Total regulatory capital to risk weighted assets	21.0	20.8	20.7	20.9	24.8
3. Total capital to total assets[1]	16.4	13.1	14.3	11.6	13.6
Asset composition and quality					
1. Non-performing loans to gross loans and advances	6.3	6.3	4.5	6.3	7.4
2. Provisions to non-performing loans	38.6	32.9	32.5	29.9	33.0
3. Total loans and advances to total assets	33.2	31.2	29.2	29	26.7
4. Foreign currency loans to total loans and advances	20.9	14.7	11.3	11.1	12.7
Earnings and profitability					
1. Return on assets (ROA)	2.7	3.0	3.4	4.1	5.4
2. Return on equity (ROE)	20.5	22.8	26.0	33.3	40.4
3. Non-interest expenses to gross income	51.8	49.0	43.7	40.3	34.8
4. Interest margin to gross income	59.6	65.6	49.7	52.2	52.4
5. Non-interest income to revenue	33.6	34.4	31.6	30.5	31.3
6. Net interest income to assets	8.4	8.0	7.9	9	4.7
7. Personnel expenses to non-interest expenses	43.0	42.5	43.4	43.7	45.9
Liquidity					
1. Liquid assets to deposits and short-term liabilities	58.9	57.5	52.5	53.5	58.4
2. Total loans to total deposits	54.2	50.0	47.9	42.9	39.8
3. Liquid Assets to total assets	39.8	39.6	37.3	39.4	42.9
4. Foreign exchange liabilities to total liabilities	15.8	16.1	14.2	13.8	13.3

Source: Reserve Bank of Malawi.

[1]In the total capital to total assets series, total capital refers to regulatory capital.

Table 6. Malawi: External Financing Requirement and Source, 2022–28
(Millions of U.S. Dollars; Unless Otherwise Indicated)

	2022	2023	2024	2025	2026	2027	2028
Total requirement	-583	-1,989	-1,454	-1,238	-1,202	-1,034	-956
Current account, excluding official transfers	-471	-1,022	-963	-944	-862	-762	-752
Debt amortization	-64	-589	-242	-196	-190	-161	-109
Gross reserves accumulation (- increase)	-49	-378	-249	-99	-150	-110	-95
Total sources	583	1,237	1,179	1,057	981	936	940
Expected disbursements (official)	1,134	1,464	1,158	1,068	992	872	918
Grants	855	1,108	918	867	841	755	774
Medium- and long-term loans	279	355	240	201	151	117	145
Private sector (net)	-611	-187	62	44	63	128	100
IMF (net)	60	-39	-41	-55	-74	-65	-79
Drawings	91	0	0	0	0	0	0
Repayments	31	39	41	55	74	65	79
Financing gap	0	752	275	181	221	98	16
Gross official reserves	120	499	747	846	996	1,106	1,202
Months of imports	0.6	2.3	3.3	3.7	4.2	4.5	4.7

Source: IMF staff estimates.

Annex I. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Global Risks			
Intensification of regional conflict(s)	High	Medium Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	Strengthen intra-regional trade among sub-Saharan African countries to overcome supply chain disruptions.
Commodity price volatility	High	Medium A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability.	Tighten monetary policy, increase exchange rate flexibility, strengthen FX reserve buffer, apply the automatic fuel price adjustment mechanism and replenish the fuel price stabilization to ensure adequate energy supplies and contain fiscal cost/contingent liabilities.
Social discontent	High	High Supply shocks, high inflation, real wage drops, and spillovers from crises in other countries worsen inequality, trigger social unrest, and give rise to financing pressures and damaging populist policies with possible spillovers to other Emerging Markets and Developing Economics. This exacerbates imbalances, slows growth, and triggers market repricing.	Encourage the authorities to maintain social priority spending in the face of falls in development assistance to build the resiliency of vulnerable populations. Undertake promised reforms in a transparent and equitable manner. Strengthen governance measures.
Systemic financial instability	Medium	Medium Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	Upfront action to address debt sustainability and avoiding external non-concessional borrowing. Resorting to debt management strategy which relies on grants and highly concessional loans.
Abrupt global slowdown or recession	Medium	Medium Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation.	Encourage the authorities to expand the domestic revenue base in order to compensate for any fall in development assistance.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 and 3 years, respectively.

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
		Regional and Domestic Risks	
Delay in debt work out	High	High Further delays in debt workout can reduce access to trade credit, forex swaps, and other short-term loans, worsen foreign exchange shortages and result in difficulties in importing key commodities (fuel, medicine and food) and servicing debt; which would in turn exacerbate dire macroeconomic conditions, poverty, and food insecurity.	Work with debt advisor(s) and take decisive policy action that is needed to restore debt sustainability and close financing gap.
Governance weaknesses	High	High Overly ambitious capital investment beyond the country's absorptive capacity and weak institutions can result in a misuse of public resources, resulting in a rise in debt with little impact on growth. Conflicting signals on policy intentions can also adversely affect market participants' confidence.	Strengthen institutions to address weaknesses in governance, roll out of IFMIS, supported by the authorities' credible reforms. Strengthen public investment management (PIM).
Delayed PFM reforms and lack of expenditure control	High	High Uneven progress of PFM reform and deficient expenditure control undermine confidence in budgetary processes and efforts to effectively and transparently manage expenditure. Re-emergence of arrears resulting from delays in PFM reforms will add to debt distress.	Accelerate implementation of PFM reform programs, strengthen commitment control, and communicate regularly and transparently
Fiscal dominance resulting in deficient conduct of monetary policy	High	High Inability to keep reserve money growth in line with nominal GDP growth can result in pressure on the exchange rate, the RBM's foreign exchange reserves, and inflation. Conflicting signals on policy intentions can also adversely affect market participants' confidence.	Strengthen RBM independence. Maintain a positive real interest rate. Reinstate a clear and effective monetary operational framework.
Natural disasters related to climate change	High	High More frequent natural disasters with severe damages to infrastructure can amplify supply chain disruptions, inflationary pressures, and water and food shortages. They would also reduce medium-term growth prospects.	Build economic resilience, through human capital investment, and addressing deforestation.

Appendix I. Letter of Intent

June 30, 2023

Madame Kristalina Georgieva
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, D.C. 20431
United States

Dear Madame Kristalina Georgieva,

The Staff Monitored Program with Executive Board Involvement (PMB) approved in November 2022, simultaneously with the approval of disbursement under the Food Shock Window (FSW) of the Rapid Credit Facility (RCF) amounting to US88.3 million, underpin our reforms to restore macroeconomic stability, with a view to improve the life of Malawians. The PMB is also supporting our efforts to build a track record for an IMF-supported Extended Credit Facility (ECF) arrangement whose catalytic impact would unlock the much-needed budget support from our development partners. Since the PMB approval, we have directed our efforts towards implementing the agreed reforms, amid the impact of shocks from Cyclone Freddy and a prolonged Cholera outbreak. Despite these shocks, we remain highly committed to the agreed reforms and we have continued to make progress on addressing stumbling blocks that have delayed the conclusion of negotiations for the successor ECF, including unsustainable public debt.

Malawi remains exposed to climate shocks. Barely a year since the two cyclones in early 2022, we were hit by Cyclone Freddy in March 2023 resulting in a significant death toll, the highest in the history of cyclones in Malawi and the destruction of critical infrastructure. In addition, from late 2022 to early 2023, Malawi experienced its worst outbreak of cholera in decades, forcing the closure of schools and businesses. Consequently, the outlook for economic growth and inflation in 2023 is relatively less favorable compared to the time of the PBM approval. The foreign exchange reserves of the RBM remain under pressure while inflation has persisted, standing at 29.2 percent as of end-May 2023. The challenging economic conditions and erosion of purchasing power have negatively affected Malawians, more so the most vulnerable households, already facing a high risk of food insecurity. We will therefore steadfastly push ahead with reforms to help alleviate this situation in line with our long-term vision to create an inclusively wealthy nation under Malawi 2063. Against this background, we are continuing to make progress on the comprehensive debt restructuring process we initiated to restore debt sustainability and build a track record with the PMB towards an IMF-supported economic program financed under an ECF.

The attached Memorandum of Economic and Financial Policies (MEFP) describes recent developments in the Malawian economy and sets out in detail the economic and financial policies we are implementing under the PMB to restore macroeconomic stability, set the foundation for inclusive growth and improve the life of Malawians. Our policies to restore macroeconomic stability will continue to focus on measures to enhance fiscal discipline, maintain price stability and financial soundness, rebuild external buffers, and restore debt sustainability. These reforms will be implemented alongside efforts to address longstanding governance weakness and corruption, including in relation to public procurement. Given our limited fiscal space, we will prioritize expenditure to ensure adequate support to the vulnerable by safeguarding Government's contribution to social safety net programs such as the Social Cash Transfer Program (SCTP), and to protect investment in infrastructure.

Performance under the First Review of the PMB based on end-Dec 2022 targets faced implementation challenges partly linked to the shocks articulated above. We have since taken strong corrective actions including completing two prior actions for the first review, namely: (i) submitting April and May Integrated Financial Management Information Systems (IFMIS) reports to IMF staff and (ii) restarting foreign exchange auctions to facilitate price discovery in the foreign exchange market. Both prior actions were met. Moreover, to be in line with updated program projections, we are requesting modification of QTs and ITs for end-June and end-September.

We are confident that through the implementation of measures and policies described in the attached MEFP, we will attain the objectives of the PMB. That said, we stand ready to take additional measures that may be needed over and above those articulated in the MEFP in consultation with IMF staff in accordance with the Fund's policy. We also assure you that we will submit all program monitoring information outlined in the attached Technical Memorandum of Understanding (TMU) on a regular and timely basis and will also pro-actively share any other information that may be necessary to evaluate progress made under the PMB. We intend to make public the contents of the IMF staff report, including this letter, the attached MEFP, the TMU, the informational annex, and the debt sustainability analysis carried out by IMF and World Bank staff. As such, we authorize the IMF to publish these documents accordingly.

Yours sincerely,

/s/	/s/
Honorable Sosten Alfred Gwengwe, M.P.	Dr. Wilson T. Banda
Minister of Finance and Economic Affairs	Governor of the Reserve Bank of Malawi

Attachments:

1. Memorandum on Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies

June 30, 2023

INTRODUCTION

1. The Government of Malawi has embarked on a wide-ranging and ambitious macroeconomic and structural reform program in line with the Malawi Vision 2063. The overarching goal of the Government's efforts is to rebalance the economy to accelerate sustainable and inclusive growth and increase resilience in the context of growing threats from natural disasters and economic shocks. In this context, Government remains deeply committed to implementing its reform agenda, which is fully aligned with our objectives under the one-year Staff Monitored Program with Executive Board involvement (PMB) approved in November 2022. This commitment will allow Government to emerge stronger from the current economic crisis, caused by a sequence of external shocks including Cyclone Freddy, and to build the foundation for sustainable development.

2. Malawi's already vulnerable macroeconomic foundation has been further damaged by a sequence of external shocks in recent months, necessitating accelerated implementation of reforms to restore macroeconomic stability and support economic recovery. His Excellency the President Dr. Lazarus McCarthy Chakwera assumed office as President of the Republic of Malawi on 28th June, 2020. At the time, it was in the midst of the COVID-19 pandemic which hit Malawi's already unstable macroeconomic conditions with significant balance of payment imbalances, debt challenges and an over-valued exchange rate. Over the past years, a combination of weather-related events, health triggered crises and the impact of the Russia-Ukraine war on inflation have put further pressure on the balance of payments and fiscal position of Malawi. The supply chain challenges that emerged from the Russia-Ukraine crisis also led to constrained access to key agricultural inputs, further increasing food insecurity for the population. These developments triggered an ongoing balance of payments crisis while Malawi is in debt distress and external debt has been assessed as unsustainable according to the IMF and World Bank Debt Sustainability Framework for Low-Income Countries (DSF-LIC). Recently, the devastating impact of Cyclone Freddy, resulting in an enormous death toll and destruction of critical infrastructure, put additional pressure on the country's fiscal and external position. This asks for a combination of emergency response to support those impacted by the crisis, while accelerating the debt restructuring process with external creditors and transition towards an IMF-supported Extended Credit Facility arrangement as soon as possible.

3. This Memorandum presents the economic and financial policies that the Government will implement to ensure that the PMB remains on track to build a track record for transition to a UCT-quality arrangement as soon as possible. The Government's overarching objective is to restore macroeconomic stability to build the foundation for sustainable and inclusive growth as envisaged in Malawi 2063. In the near term, BoP pressure is elevated calling for a steadfast implementation of ambitious reform efforts to help improve the lives of the Malawian people.

4. Performance under the First Review of the PMB based on end-Dec 2022 targets faced implementation challenges partly linked to the shocks articulated above. The domestic primary fiscal balance target was not met, partly because of spending needs due to the currency devaluation, cyclone Freddy, health crisis and inflation, as well as the difficulty of reversing the course late in the fiscal year. That said, the domestic revenue and social expenditure targets were met. An effort to address overvaluation of the exchange rate in May 2022 led to losses on the central bank balance sheet, which required recapitalization by the government. This caused a breach of the targets on RBM financing of the government (ceiling) to not be met.[1] The target on NIR was not met by only a narrow margin. That said, the ceiling on contracting or guaranteeing of external debt was met. The targets for end-March were mostly met. Implementation of several structural benchmarks (SBs) faced delays.

5. Going forward, we will ensure that we keep the PMB on course to help build a track record to move swiftly to an ECF arrangement that can catalyze much needed grant financing. To achieve this, we will take the necessary steps to: 1) deliver on the agreed PMB objectives and program targets, including through the prior actions; and 2) make tangible and expedited progress on the debt restructuring process to fully restore debt sustainability in line with the parameters that underpinned the PMB request. Notably, we have passed a FY2023/24 budget that is aligned with the macroeconomic adjustment path required for stabilizing the economy, underpinned by a combination of enhanced domestic revenue mobilization and expenditure rationalization, to reduce the pressure on domestic borrowing and public debt. The Reserve Bank of Malawi (RBM) acted by tightening the monetary policy stance to help contain inflationary pressures. We will continue stepping up our efforts to address governance weaknesses and reduce vulnerabilities to corruption, including through enhancing transparency, accountability, and digitization of public financial management (PFM), enhancing autonomy and governance of the RBM, and strengthening of its foreign exchange reserves position and management.

RECENT ECONOMIC DEVELOPMENTS

6. Malawi's economic recovery remains extremely fragile. After a sizeable recovery from 0.9 percent in 2020 to 4.6 percent in 2021, on the back of a good harvest, real GDP growth declined to an estimated 0.8 percent in 2022. This reflects the effect of the two tropical storms that hit Malawi in the first quarter of 2022, delayed and early cessation of 2021/22 agricultural season rains, intermittent electricity power supply and spillover effects of the war in Ukraine through higher fuel, fertilizer and food prices.

7. Fiscal policy faced challenges in FY2022/23. The deficit in FY2022/23 is MWK 1.48 billion (11.8 percent of GDP), compared to a projection of MWK 1.08 billion (9.0 percent of GDP) at the time of the PMB. The domestic primary fiscal deficit in FY2022/23 was MWK 479 billion (3.8 percent of GDP), compared to a projection of 0.6 percent at the time of the PMB. The slippage was largely

[1] Quantitative target on RBM financing would not have constituted a breach, had there not been for the statutorily required recapitalization of the RBM following revaluation losses due to exchange rate movements.

on the expenditure side, with inflation driving large expenditure overruns and as the revised FY2022/23 budget came late in the fiscal year, when it was difficult to reverse course on government spending. On the revenue side, the outturn of tax revenue of 12.7 percent of GDP was close to 13.1 percent projected at the time of PMB approval.

8. Gross official reserves remain low and pressure on the exchange rate is high. The current account deficit narrowed significantly to 3 percent of GDP in 2022 from 14 percent of GDP in 2021 partly due to a large devaluation and import compression. Despite a large reduction in the current account deficit, reserve accumulation was limited, in part due to sizeable external debt service. Foreign exchange market liquidity remains significantly tight, with FX demand significantly high (including for mounting external debt service) and FX prioritized to support strategic imports. Supply has been further constrained by underperformance of exports. As a result, readily available gross reserves were $120.2 million at end-2022, up from $71.7 million at end-2021. The recent Cyclone Freddy has put further strain on gross reserves, leaving the level of gross reserves low. Since the 25 percent exchange rate devaluation at end-May 2022, the spread between the US$/Kwacha bureau and the official exchange rate has reopened and widened to over 40 percent, reflecting some speculative behaviors on the cash FX market.

9. Inflationary pressure is persisting. Average overall inflation in 2022 rose to 20.8 percent from 9.3 percent in 2021. Inflation (year on year) in May 2023 was 29.2 percent—food and non-food y-o-y inflation continued to accelerate, reaching 38.8 percent and 18.4 percent, respectively. This reflects lingering exchange rate pass-through from the 25 percent devaluation in May 2022, increases in prices of fuel, fertilizer and imported food amid prolonged global supply disruptions, and the impact of expansionary fiscal stance in FY22/23. In response, the RBM raised the policy rate by 400 basis points to 22 percent in April 2023.

10. The banking sector is broadly stable, well capitalized, with sufficient liquidity and profitability, but exposure to the public sector has continued to increase. The banking sector meets the minimum regulatory requirements for capital adequacy and the liquidity ratios. However, since the Covid-19 pandemic, industry-wide non-performing loans generally remained above the recommended limit of 5.0 percent, and stood at 7.4 percent in May 2023, up from 2.0 percent in May 2022.

11. Risk to food security is high and increased on account of climate-induced shocks and lingering spillovers from the war in Ukraine. Vulnerability to natural disasters has aggravated food insecurity by further depressing food production, and other exported agricultural products (tobacco) which provided sources of foreign exchange to purchase other necessary food imports. The destruction of crops caused by Cyclone Freddy will add to the already high pressure on food security.

OUTLOOK

12. While the macroeconomic situation is dire, implementation of bold policies and corrective actions outlined in this MEFP is expected to lead a favorable medium-term outturn.

We will take the necessary steps to ensure that the PMB is on track to help anchor our macroeconomic policies to address macroeconomic sustainability. In this regard, we will implement bold policies and reforms, accompanied by strategies to restore debt sustainability. Furthermore, we will continue to advance structural reforms to support sustainable and inclusive growth and restore debt sustainability, with a view to improve lives of the Malawian people.

13. We are cognizant that in the short term, the impact of economic adjustment will be difficult, but this is necessary to address the current situation and set the foundation for sustainable and inclusive growth.

- We expect that growth will recover from 0.8 percent projected in 2022 to 1.7 percent in 2023 as confidence in our policies and economic stability is restored. Specifically, we will pursue prudent fiscal policies and ensure that non-concessional external financing will be replaced by grants, other non-debt creating flows and adjustments under the proposed reform program. Medium-term growth is projected to settle around 4.6 percent, supported by greater macroeconomic stability and implementation of structural reforms.

- Average year-on-year inflation is expected at 24.8 percent in 2023 and projected to decline thereafter towards about 6.5 percent in the medium term, supported by well anchored monetary and fiscal policy stance, taking into account the anticipated movements of the currency and passthrough to inflation as the RBM builds up foreign reserves and winds down currency swap operations.

- We will aim to accumulate gross reserves to reach $499 million by December 2023. Gross reserves are projected to recover to over 4.5 months of imports in the medium term. With external and fiscal policy adjustments, current account deficits are projected to stabilize over time. The reserve accumulation path assumes that the external financing gap will be filled with non-debt creating flows, either debt relief or grants, and concessional loans.

14. Risks to the outlook are significant. Without sufficient external buffers, BOP pressures may further intensify. Further weather-related shocks could also disrupt economic activity. In addition, the war in Ukraine could compound risks to the outlook due to supply chain disruptions and the surge in fuel, food and fertilizer prices resulting in additional financing needs and increasing risks to food security.

ECONOMIC AND FINANCIAL POLICIES FOR THE PROGRAM PERIOD

15. Economic and financial policies for the program period will be anchored by the Malawi 2063 agenda. Our program objectives include, (i) restoring macroeconomic stability, (ii) enhancing fiscal discipline, (iii) maintaining price stability and financial soundness, (iv) rebuilding external buffers, (v) restoring debt sustainability and closing the financing gap, and (vi) addressing weaknesses in governance. The remainder of this MEFP outlines in detail the specific policies we have adopted or intend to adopt to achieve our program goals.

A. Fiscal Policy

16. Our fiscal policy stance will aim to regain fiscal discipline and restore debt sustainability. This will be supported by measures to enhance revenue collection and manage expenditures and improve transparency and monitoring of budget execution.

17. The passed FY2023/24 budget is in line with the program macroeconomic framework. The budget aligns spending to revenue projections so that net domestic financing is contained. The budget is anchored on a realistic revenue estimate and a rationalization of expenditure, while protecting essential spending, to achieve a fiscal adjustment of about 1½ percentage points of GDP in FY2023/24. The envisaged reduction of the domestic primary deficit excluding those flows related to recapitalization of the RBM is 1.3 percentage points of GDP in FY2023/24.

18. In the medium-term, a primary balance of 0 percent of GDP is needed to stabilize public debt, representing a cumulative fiscal consolidation of 6.0 percentage points (in terms of domestic primary balance) over the four years from FY2022/23. To achieve fiscal discipline and move towards a sustainable debt path, our fiscal consolidation efforts during FY2023/24 will focus on (i) stepping up implementation of our domestic revenue mobilization strategy (DRMS) in a timely manner (ii) rationalizing and prioritizing expenditures, (iii) introducing and implementing sound commitment controls measures and (iv) implementing well targeted measures to support low-income households.

Text Table 1. Malawi: Fiscal Adjustment, 2022/23–2025/26 at the PMB Approval
(Percent of GDP)

	2022/23	2023/24	2024/25	2025/26	Total
Domestic Revenue	**0.5**	**1.0**	**1.0**	**0.4**	**2.9**
Policy measures	0.4	0.9	0.9	0.2	2.3
Import withholding tax	0.1	-	-	-	0.1
VAT base broadening	0.2	0.5	0.5	0.1	1.2
PIT reform	0.2	0.2	0.2	-	0.6
CIT base broadening	-	0.1	0.1	0.1	0.3
Excise and Carbon Tax	-	0.1	0.1	-	0.2
Tax administration measures	0.1	0.1	0.2	0.2	0.6
Expenditure measures	(1.5)	(0.5)	(0.3)	(0.2)	(2.6)
Wage bill	(0.3)	(0.3)	(0.3)	(0.1)	(1.0)
AIP	(0.6)	(0.3)			(0.9)
General goods and services	(0.5)	(0.2)	(0.1)	(0.1)	(0.9)
Social protection		0.2			0.2

19. We will announce quarterly allotments aligned with the macro-framework and the outturns for revenue, grants and expenditure and allow Ministries Departments and Agencies (MDAs) to commit up to this amount through IFMIS. MDA payments will be limited to monthly cash releases, aligned with allotments, to demonstrate our commitment to stronger expenditure control reforms, reducing the risk of accumulating new payment arrears. The extension of this practice to all MDAs was done through announcement in the 2023-24 budget speech and is now being executed.

20. Our revenue mobilization efforts will be driven by the timely implementation of revenue measures announced in the Domestic Revenue Mobilisation Strategy (DRMS) and FY2022/23 and FY2023/24 budget statements. We launched the DRMS in December 2021 with the objective to increase revenue by 5 percent of GDP in the five years of implementation. To step up implementation, we have incorporated the DRMS in Malawi Revenue Authority's (MRA) strategic plan and formulated a DRMS Monitoring Committee comprising MoFEA, MRA, Accountant General, Immigration Department, Malawi Police Service and Registrar General in FY2022/23. The following measures are being implemented as part of the DRMS:

- **PAYE Brackets:** we introduced additional income tax brackets in April 2022, partly reversing the loss in revenue from previous changes in rates and brackets.

- **Advance income tax:** we rolled out full implementation of the advance income tax in May 2022 which raised additional revenue amounting to MWK 6 billion. The rate on the advance income tax will increase from 3 percent to 10 percent in FY 2023/24.

- **Tax stamps on beverages:** we are in the process of introducing the requirement for affixing or printing of electronic tax stamps on alcohol (spirits, whiskey, malt beer, opaque beer), energy drinks, flavored water, carbonated soft drinks and opaque non-alcoholic drinks. We expect this to be operational in FY2023/24.

- **New stamp duties:** New stamp duties will apply to various instruments, including motor vehicles, in FY2023/24.

- **Taxes for small businesses**: we have introduced presumptive tax for small businesses whose turnover is less than MWK12.5 million. To ensure that the presumptive tax system is effective, we are rolling out the block management system in all commercial centers starting with T Lilongwe, Blantyre and Mzuzu.

- **Tax Incentives:** the FY2022/23 budget announced establishment of Special Economic Zones, to help catalyze the much-needed foreign investment in Malawi. As far as tax incentives are concerned, we are reviewing the system with a view to streamline the incentives. The recommendations of the report will be incorporated in the new Taxation Act, Value Added Tax Act, and Customs and Excise Act that are currently under review.

- **Bank Supernormal Profits Tax** we introduced an additional income tax of 10 percent for bank profits above MK10 billion. Thus, bank profits below MK10 billion will continue to be taxed at 30 percent, while profits above Mk10 billion will be taxed at 40 percent. This is a temporary measure that will be reviewed in the next fiscal year.

- **Introduce VAT on some products:** we have introduced standard rate VAT on the following products: exercise books with hard covers; rye flour; other cereal flour; groats and meal of wheat, groats and meal of other cereals; rolled or flaked grains of oats or other cereals; other worked grains of oats or other cereal; cereal, germ, whole rolled flaked or ground; roasted malt; and malt roasted of barley, oats, rye, sorghum or mullets.

- **Increase the withholding tax on contractors from 3 percent to 10 percent:** as one way of increasing tax compliance in the construction industry, we have increased the WHT rate for the industry from 3% to 10%.

- **Collect rental income tax from residential houses:** realizing that there are more Malawians who have several residential rental houses but are not paying taxes, we have embarked on a project to register all houses in cities and towns and start enforcing the payment of rental income tax.

21. To strengthen tax administration, we are on track with the go-live launching of the Integrated Tax Administration System (ITAS), also called Msonkho online December 2022 with all modules by March, 2023. Currently, all modules that are used by taxpayers such as registration, payment of taxes and filing of tax returns, are operational. The outstanding modules relate to those that will be used by the authority such as audit and risk profiling of taxpayers.

22. To improve non-tax revenues, we have implemented measures, including ensuring that SOEs comply with the PFM Act by opening a holding account with the RBM; ensuring that MDAs remit non-tax revenue collection to MG1 account through their departmental receipts accounts, and increasing some fees and charges to ensure that they reflect, where possible, full cost recovery. More increases to fees and charges are planned, as well as additional measures, including automating the payment systems and business processes of the MDAs; and enforcing the dividend and surplus policy.

23. Expenditure prioritization is more critical than ever given the need to support the vulnerable and invest in infrastructure. We will endeavor to improve efficiency of public spending and to reduce non-critical spending.

- **Continue to rationalize the Affordable Input Program.** We have implemented the first phase of reform to the fertilizer and seed subsidy program (Affordable Input Program (AIP)) by having a National Integrated Social Safety Net Program using the Unified Beneficiary Register to reduce duplication of access hence bringing in efficiency in beneficiary targeting. We have taken necessary measures to prevent cost overrun in the AIP from escalating fertilizer prices and kwacha depreciation including through increment to farmer contribution while capping the Government Subsidy and fast-tracking beneficiary reform. In subsequent phases of the AIP reform, we have adopted a plan to phase out the AIP.. Furthermore, we have moved farmers at the lowest end of the income spectrum to social protection programs and those at the higher end of the spectrum to commercial agriculture programs, supported by development partners.

- **Rationalize the wage bill.** The Personnel Audit was carried out in 2021, which provided a number of recommendations, and the Government of Malawi is committed to manage its wage bill by flushing our ghost workers, freezing on new hiring to the public service, except in critical areas such as health and education sector, strengthening approval processes to payroll and pension changes within the existing Human Resource Management Information System (HRMIS).

- **To safeguard social protection and to protect the vulnerable, we have established a floor on social spending as an indicative target (IT) under the program.** This will comprise of Government contribution to health and basic and secondary education spending, as well as a number of social safety net spendings, including the social cash transfer program (SCTP) and AIP. Fiscal measures were put in place to mitigate food insecurity (Box 1).

Box 1. Malawi: Fiscal Measures to Mitigate Food Insecurity, FY2022/23

Proposed Areas	Amount Proposed (K billion)	Amount Spent (K billion)	Justification	Reporting
Social Cash Transfer	2	2	To help the vulnerable groups such as the elderly, children, disabled by providing them with social cash transfers. The additional resources to be used for scaling up the program under Ministry of Gender	Social Spending Tracker
Affordable Inputs Program	69.8	144.2	This will enable Government to cushion farmers from high/increased prices of fertilizers	Line item in the budget, monthly reports and social spending tracker
Maize/Other Food Stuffs Purchase-Lean season response	12.6	12.6	To procure additional maize and other food stuffs under Disaster Affairs Department for lean season response (December 2022 – March 2023)	Social Spending Tracker
Livestock Develop-ment Initiatives	0.5	0.6	To target livestock farms such as Dwambadzi for goat, cattle and other livestock in the Ministry of Agriculture	Social Spending Tracker
Maize Seed subsidy	4.4	0.2	To provide good quality seeds to vulnerable population in order to enhance maize production.	Social Spending Tracker

Box 1. Malawi: Fiscal Measures to Mitigate Food Insecurity, FY2022/23 (concluded)

Proposed Areas	Amount Proposed (K billion)	Amount Spent (K billion)	Justification	Reporting
Agriculture Sector	8.6	26.5	To support Ministry of Agriculture in Agricultural extension services and land conversation agricultural measures	Line item in the budget through monthly budget execution reports
Sub-Total	**97.9**	**186.1**		

24. We have stepped up measures to enhance the oversight of state-owned enterprises (SOEs). Weak oversight and financial reporting are a challenge to adequate monitoring and management of risks to the budget and public debt from the SOEs. In this regard, we will keep close track of government guaranteed debt of SOEs. We have undertaken detailed reporting to the Parliament for FY2022/23 for high-risk SOEs, including Blantyre Water Board, ESCOM, ADMARC, NOCMA and EGENCO. On a quarterly basis, we will monitor the management accounts of the relevant SOEs. In compliance with the new PFM Act, we will continue to prepare an annual consolidated report of all SOEs.

25. Implementation of the new IFMIS, institutionalizing reporting and controls are key for execution of the budget and commitment control. We will exploit the new IFMIS, which started in July 2021, to build upon recent and enable future Public Finance Management (PFM) reforms, including the interim Electronic Funds Transfer (EFT) for government payments, to improve our budget preparation, cash management, commitment control, banking arrangements, accountability, and payment efficiency. As of May 2023, 50 MDAs are included in IFMIS and an additional 30 MDAs will be added July 1, 2023. The success of the fiscal adjustment program relies heavily on comprehensive and timely reporting, and sound commitment controls. Our measures are as follows:

- **Arrears:** We have completed the verification of arrears of the national budget entities from 1st July 2017 to 30th March, 2022. We are in discussion with the Auditor General on the stock of the unverified arrears to agree on how these will be treated and in addition, on the stock of arrears that have been inspected but not verified. We are committed to settle the arrears within the limits of the fiscal framework and available resources and to avoid further accumulation of arrears through implementation of quarterly allotment, enhancement of commitment controls and implementation of contract management module within IFMIS. To curb arrears on utilities we are promoting the installation of prepaid meters for all MDAs and rehabilitating water reticulations systems in key public institutions to reduce non-revenue water. From April 2023 we have commenced regular quarterly surveys of the bigger spending MDAs and those with histories of payment arrears to provide early warnings of accumulating arrears enabling timely corrective actions.

- **Contract Management module of IFMIS-** starting mid November 2022, we implemented quarterly commitment limits (backed by monthly payment fundings) and rolled out the IFMIS contract management module starting with two MDAs, including the Ministries of Health and Transport. We will roll out to the remaining MDAs by end-December 2023. Applying the lessons learned from the pilot exercise and rolling out these functions to all MDAs will form our cornerstones for firm commitment control and management of multi-annual contracts. Implementation will include i) capturing all existing contracts/commitments in IFMIS, ii) issuance of quarterly spending limits and monthly payment funding, iii) requiring all financial transactions to be entered through IFMIS at the commitment (contract signing/purchase order issuance) stage. We envisage rolling out the functionalities to all MDAs during the course of FY2024.

- **Expand the coverage of transactions recorded in IFMIS** to include items that in the past have transacted outside of IFMIS from April, 2023, including actuals of all revenue, domestic debt issuance receipts and all debt servicing payments, transfers to local councils, non IFMIS MDAs, and advances to embassies. We have reviewed the bank account structure used for public debt to ensure compliance with the new PFM Act, facilitate the recording of transactions and prevent payments through unfunded bank accounts.

- **Cash management and debt issuance:** to strengthen our cash management and debt issuance, we will strictly adhere to the budget execution process stipulated in the flow chart shown in the PMB staff report.

- **Electronic Funds Transfer (EFT):** Expenditure continues to be exclusively done through EFT for government payments across all MDAs. The GOM will cease to act as a participating bank in the interbank payment system.

- **Consolidated fiscal reports:** We are expanding the IFMIS coverage to include all national government cash inflows and outflows, including all MG1 and public debt issuance and servicing transactions and are working to record all missing data from July 2021. Auto-reconciliation of government's bank statements has started, enabling us to commence compiling IFMIS-generated monthly fiscal reports. So far, we have compiled the domestic budget execution data for FY2023/24. Going forward, we will continue to improve the in-year comprehensive monthly fiscal reports with the ultimate goal to publish the quarterly IFMIS-generated comprehensive fiscal reports starting in FY2023/24 These reports will be backed by reconciled bank statements submitted within three weeks from the end of each month.

- **PFM Act:** We passed the new PFM Act in March 2022 to align the legal framework with ongoing PFM reforms. We are drafting the regulations and Treasury instructions to support the implementation of the new Act. The regulations and instructions will be finalized before end-September 2023. Prior to their promulgation, we intend to share the drafts with the IMF and other development partners inviting feedback.

B. Maintaining Price Stability and Financial Soundness

26. Monetary policy will focus on containing inflationary pressures. To anchor inflation expectations, we stand ready to tighten monetary policy as needed. In this respect, our monetary program will remain anchored on containing reserve money growth. This will call for measures to contain money growth against excess liquidity created through sizeable foreign exchange purchases from the market that we envisage to build up FX reserves. Our measures will include:

- Maintaining a tight monetary policy stance by setting the monetary policy rate to ensure positive real interest rates to tame inflation.
- Draining excess liquidity through various instruments including raising required reserves, RBM's sales of government securities, and Open Market Operations (OMO) should be considered for sterilization purposes. In particular, the RBM will contain net claims on government in order to meet the zero ceiling on RBM financing of the government.

27. Financial sector stability will continue to be safeguarded. The further increase in the exposure of the banking sector to the public sector and hikes in the interest rates may pose potential risks to the soundness of the financial sector. We will therefore remain vigilant to these risks and continue to strengthen financial sector oversight. To promote financial stability, we will:

- Monitor closely the banking system's exposure to the government through securities and swap operations, and
- Reassess loan and collateral quality needs of commercial banks.

C. Rebuilding External Buffers

28. Our external policies will support rebuilding of FX buffers, in a sustainable manner, and maintaining a market determined exchange rate. To achieve this objective,

- We will implement the agreed path towards accumulating foreign exchange reserves with the view of rebuilding the country's reserve assets. The RBM will purchase foreign exchange necessary to build reserves, and at the same time limit foreign exchange sales to the market—thus, becoming a net purchaser of foreign exchange. We believe that pursuing this reserve accumulation strategy will help achieve at least 3 months of import cover in the medium term. Moreover, we will also monitor short-term foreign currency drains to consistently monitor RBM's external vulnerability.
- We are mitigating against FX swap rollover risks and decreasing swap costs by winding down FX swaps with non-residents—in accordance with our plan to reduce the open swap position during the medium term.

- The RBM will resume transparent foreign exchange auctions to promote price discovery and greater flexibility in the exchange rate and to foster the development of the interbank FX market (PA) and will continue those auctions on a monthly basis.

- We will ensure that coordination between the government and the RBM will help achieve the external sector policy goals. In particular, the government will stay on track with the fiscal program to manage fiscal implications on foreign exchange and the export sector to help improve the medium-term current account balance.

D. Restoring Debt Sustainability and Closing the Financing Gap

29. Malawi's overall and external public debt is assessed to be in debt distress. This mainly reflects legacy debts that we inherited, driven by unsustainable fiscal and external policies. Restoring public debt sustainability is our top priority to support macroeconomic stability and to lay the foundation for sustainable and inclusive growth.

30. We have developed a debt restructuring strategy which will serve as our cornerstone for restoring debt sustainability. Both external and domestic debt are assessed as unsustainable under current policies; conditional on completion of the ongoing debt restructuring process, debt is sustainable on a forward-looking basis. Our debt strategy is designed to achieve debt sustainability and to close the financing gaps. The strategy relies on the following pillars to overcome current external debt challenges, including solvency and liquidity concerns:

- Bringing external public debt back to a moderate risk of debt distress in the medium term through a combination of policy adjustment and the necessary debt treatment. The debt strategy targets all external DSA solvency and liquidity ratios to cross their respective thresholds under the baseline in the next five years. This means (i) the baseline of the present value of debt-to-GDP ratio to reach below 30%, (ii) the present value of debt-to-exports ratio below 140%, (iii) the external debt service-to-exports ratio below 10%, and (iv) the external debt-to-revenue ratio below 14% in the medium-term.

- Mobilization of non-debt creating flows to ensure the external and fiscal financing gaps are closed over the medium term, including through the debt treatment and the mobilization of external grant support from development partners.

31. We are committed to pursue public finances consistent with debt sustainability and implement measures to strengthen debt management, monitoring recording and reporting. To ensure our debt remains on a sustainable path, we will implement measures articulated below:

- To enhance public debt management, we have updated and published our medium-term debt strategy (MTDS) to take into account on-budget externally and domestically financed projects either contracted or expected as reflected in the macro-fiscal framework. The MTDS also reflects the ceiling on new non-concessional external debt contracted or guaranteed that applies to Malawi as required by the Fund's Debt Limit Policy.

- We will adopt best practices in terms of data reporting and transparency, as well as fulfil our reporting duty to the Fund during the Staff's program review or upon request. In particular, we reiterate our commitment to continue to integrate public debt data into IFMIS. To further enhance transparency around Malawi's debt data, we are continuing to publish regular reports on outstanding debt figures on our official websites. Finally, we are dedicated to building capacity around debt management and financing and to seeking technical assistance from the IMF and other partners.

- To further support debt sustainability, we will undertake a fiscal adjustment while limiting the impact on economic growth and protecting vulnerable populations through our revenue mobilization efforts.

- Finally, to rebuild our external buffers over the medium term and improve liquidity, we will continue to implement our National Export Strategy. In addition, we aim to reduce Malawi's dependance on agricultural exports, thereby building resilience to climate shocks while supporting economic growth over the medium term.

E. Tackling Governance Challenges Structural Reforms

32. Strengthening RBM's autonomy, governance arrangements, and reserve management are cornerstones of our program. In this regard:

- We have developed a revised framework for management of foreign reserves in accordance with recommendations of the 2021 Safeguards Assessment Report and shall ensure its endorsement by the ALCO and the Board.

- The RBM Board has established an Asset Liability Management Committee (ALCO) in accordance with recommendations of the 2021 Safeguards Assessment Report.

- We will prepare, in consultation with Fund staff, and submit the amendments, as recommended by the 2021 safeguards assessment, to the RBM Act to public consultation first then to the Parliament **(SB).**

- To strengthen accuracy of RBM's program monitoring data, we will (i) institute a policy to have our external auditors verify NIR data within 10 weeks after each test date, and (ii) submit monetary data through standard reporting forms to the Fund on a regular basis.

33. The misappropriation of COVID-19 public funds is a stark reminder of the urgent need to address longstanding governance weaknesses. Preparations are underway for specific follow-up actions needed to implement audit recommendations for the two tranches.

34. Governance weaknesses at the Export Development Fund (EDF) pose a risk to the government in terms of contingent liabilities. EDF is a wholly owned subsidiary of RBM but the

Government is working on modalities to merge EDF with Malawi Agricultural and Industrial Investment Corporation, PLC (MAIIC).

35. We have renewed our commitment that public procurement is conducted transparently and in full accordance with proper procedures and the PFM Act. A barter trade deal to secure access to fertilizer in exchange for crops raised a number of governance concerns and the Attorney General advised the deal to be halted because the transaction was undertaken without the proper procurement and authorization procedures. In light of this, we are taking all the necessary steps to nullify this deal and to avoid recurrence of such incidences in the future. We also confirmed that the Government has a manual repository of contracts (which are also recorded in excel) and has made available to Fund staff a full repository of contracts that would give rise to actual or contingent external debt liabilities of the government and the RBM. We recommit to following the appropriate public procurement procedures and adhering to the limits on contracting and guaranteeing nonconcessional and concessional external debt set forth in the PMB. We requested a governance diagnostic technical assistance from Fund staff to identify any weaknesses in regulation, legislation, and compliance.

36. Broader governance agenda. Mindful of the obvious fact that corruption harms society, undermines national economic development, and threatens democracy, the Government adopted a strategy to combat corruption. His Excellency the President Lazarus McCarthy Chakwera, from the outset of his administration, set out the 'golden thread of conditions' with the objective to ensure that the Malawi economy is put on a path to economic recovery and strives. Among the conditions, the rule of law, the presence of law enforcement institutions, and the absence of corruption stood out. The Government's strategic response to corruption includes four components used to combat serious and organized crime. These include: (a) prosecuting and disrupting people engaged in corruption (Pursue); (b) preventing people from engaging in corruption (Prevent); (c) increasing protection against corruption (Protect); and (d) reducing the impact of corruption where it takes place (Prepare). The plan will be reviewed on a regular basis, as part of the Government's commitment to open partnership with all key stakeholders in combating the scourge. To facilitate implementation of the strategy,

- Office of the Director of Public Asset Declarations (ODPOD) will digitise asset declarations for easy access and transparency. This will include the establishment of an interface system between ODPOD and Anti-Corruption Bureau (ACB) to facilitate lifestyle audits by September 2023.
- Strengthen collaboration among the Financial Intelligence Agency (FIA), the Director of Public Prosecutions (Asset Forfeiture Unit) and ACB in tracing assets belonging to suspects for freezing and subsequent confiscation by September 2023.
- We have operationalized the Financial Crimes Court to fast track prosecution of financial related crimes
- We have removed the requirement by the ACB to obtain consent from the Director of Public Prosecution to effect arrests for suspected corruption cases.

- The ACB will establish and sign a Memorandum of Understanding of cooperation with selected MDAs by June 2023 to facilitate data and information sharing for combating corruption purposes.

- We will request technical assistance from the IMF for a governance diagnostic.

F. Enhancing Transparency and Accountability of Strategic Imports

37. The Government will ensure publication of strategic imports data on a timely manner. More specifically, MERA has started publishing monthly volume, value, and prices of fuel importation by importers. Ministry of Agriculture, in collaboration with the Malawi Fertilizer Association, will publish those of fertilizers for the AIP; and Central Medical Stores Trust (CMST) will publish those of medical supplies.

PROGRAM MONITORING, PRIOR ACTIONS AND STRUCTURAL BENCHMARKS UNDER THE PMB

38. The macroeconomic policies supported by the PMB will be complemented by a strong structural program, which will make the transmission of economic policy more efficient. The Prior Actions (Table 3) signal our commitment to a strong reform agenda, while the Structural Benchmarks for November 2022-November 2023 will anchor our structural reform agenda during the course of the program (Table 2). The quantitative targets (QTs) and indicative targets (ITs) under the PMB are outlined in Table 1.

Table 1. Malawi: Quantitative and Indicative Targets[1], 2022–23

	Target type [2]	2022				2023					
		End-Dec.				End-Mar.				End-Jun.	End-Sep.
			Adjusted				Adjusted			Proposed	
		QT	QT	Est.	Status	IT	IT	Est.	Status	QT	IT
I. Monetary targets (billions of kwacha)											
Monetary base (ceiling on stock) (upper bound)[3]	QT	590.2				607.6		578.5		633.3	685.6
Monetary base (ceiling on stock)[3]		573.0		570.9	met	589.9		561.7	met	614.9	665.6
Monetary base (ceiling on stock) (lower bound)[3]		555.8				572.2		544.8		596.4	645.6
II. Fiscal targets (billions of kwacha)											
Domestic revenue (floor)[6]	IT	1,202.7		1,230.6	met	1,603.5		1,658.5	met	418.1	834.6
Domestic primary fiscal balance (floor)[4,6]	QT	-17.1	-36.2	-198.8	not met	-70.0		-304.4	not met	-7.4	-83.0
RBM financing of central government (ceiling)[6,7]	QT	0.0	158.2	215.9	not met	0	158.2	212.2	not met	0	0
New domestic arrears (ceiling)[6]	IT	0.0		n.a.	n.a.	0		148.3	not met	0	0
Social spending (floor)[6,8]	IT	503.7		610.4	met	669.3		868.1	met	203.2	409.8
III. External sector targets (US$ millions, unless otherwise indicated)											
Change in net international reserves of the RBM (floor)[5]	QT	141.3	122.7	116.0	not met	7.0	-23.8	-16.3	met	87.9	150.4
Accumulation of external payments arrears (ceiling)[6,9]	QT	0		0	met	0		0	met	0	0
Contracting or guaranteeing of non-concessional external debt (ceiling)[6,9,10]	QT	0		0	met	0		0	met	0	0
Contracting or guaranteeing of concessional external debt (ceiling)[6]	IT	15		284	not met	30		284	not met	0	0
Memorandum items:											
Program exchange rate (kwacha per US$)		1,026.4		1,026.4		1,026.4				1,026.4	1,026.4

Source: IMF staff projections.

[1] Targets are defined in the technical memorandum of understanding (TMU).

[2] "QT" means Quantitative Target and "IT" means Indicative Target. The QT test date for the 1st Review is end-December 2022. Test dates for future reviews will be end-June 2023. End-March and end-September 2023 targets are ITs.

[3] QT applies to upper bound only. See TMU for details.

[4] Targets are subject to an adjustor for general budget support, as specified in the TMU.

[5] Targets are subject to an adjustor for (i) debt service and fees and (ii) general budget support, as specified in the TMU.

[6] Defined in nominal terms as a cumulative flow, starting from the beginning of the fiscal year. Note that targets were set from the beginning of the program.

[7] Targets are subject to an adjuster equivalent to 10 percent of the average of the inflation adjusted domestic revenues of the previous three fiscal years, as specified in the TMU.

[8] Priority social spending as defined in the TMU and quantified in the authorities' budget.

[9] Evaluated on a continuous basis.

[10] For program purposes, a limited exception on NCB may be allowed only in the exceptional circumstance that it is used to wind down maturing swaps and for debt management operation that improves the overall debt profile.

Table 2. Malawi: Structural Benchmarks under the Staff Monitored Program		
Actions	**Timing / Status**	**Objectives**
Fiscal reforms		
Roll out full functionalities of IFMIS to all MDAs. The full functionalities will include: (i) capturing all existing contracts / commitments in IFMIS, (ii) issuance of quarterly spending limits and monthly payment funding, (iii) requiring all financial transactions to be entered through IFMIS at the commitment.	End-March 2023 **Not Met**	Interconnectedness; internal control over transactions; eliminate unnecessary duplications; achieve comprehensive coverage in IFMIS; reduce vulnerabilities to corruption. Ensure new IFMIS delivers on accountability and efficiency in the execution of PFM reforms.
Submit the audited fiscal report of FY2021/22 to IMF staff.	End-December 2022 **Met**	Foster accountability and monitoring.
Notify the FY2022/23Q3 quarter allotment to the pilot MDAs that is in line with the macroeconomic framework and allow MDAs to commit up to this amount through IFMIS.	End-December 2022 **Met**	Demonstrate capacity to monitor and control commitments.
Publish the quarterly audited IFMIS-generated comprehensive monthly fiscal reports.	Continuous, starting in FY2023/24 **In progress** **This SB will be replaced with the next SB for the second review.**	Foster fiscal transparency and monitoring. Improve the in-year comprehensive monthly fiscal reports.
Publish the monthly IFMIS-generated comprehensive fiscal reports	Continuous, starting FY2023/24	Foster fiscal transparency and monitoring. Improve the in-year comprehensive monthly fiscal reports.
Complete verification of arrears of national budget entities from July 1, 2020 to March 31, 2022 certified by the Auditor General, including compensations and utilities.	End-December 2022 **Met**	Foster financial discipline
Approval by the Cabinet of an arrears clearance and prevention strategy for national budget entities that has been prepared in consultation with staff.	End-February 2023. **Not met**	Foster financial discipline.
Monetary and Financial sector reforms		
Pre-announcement of forex purchases to allow for a period of market-price formation	End-November 2022 **Not met**	Deepen the interbank FX market, improve market functioning, efficiency in

Table 2. Malawi: Structural Benchmarks under the Staff Monitored Program (concluded)		
Actions	**Timing / Status**	**Objectives**
	Replaced to PA	intermediation with improved liquidity.
Monetary and Financial sector reforms		
Prepare, in consultation with Fund staff, and amend the RBM Act as recommended by the 2021 safeguards assessment; and submit amendments to public consultation first then to the Parliament.	End-October 2023 **In progress**	Strengthen RBM governance.
Establish an executive Asset Liability Management Committee (ALCO) in accordance with recommendations of the 2021 Safeguards Assessment Report; and fully operationalize the ALCO.	End-March 2023 **Not Met**	Strengthen oversight of foreign reserve assets.
Governance		
Follow-up action report on the COVID-spending audit report and EDF's audit report. Publish a follow-up report related to the COVID-spending audit report, detailing the corrective actions and measures to pursue and respond to audit findings, including the follow-up of alleged misappropriation of funds as well as the coverage of a second audit findings.	End-October 2023 **In progress**	Strengthen governance and data transparency.

Table 3. Malawi: Prior Actions Under the Staff Monitored Program

Actions	Objective	Status
Fiscal reform		
Submission to IMF staff of April and May In-Year IFMIS-generated reports that show at a minimum the following items have been entered in the IFMIS: (i) all revenues and grants deposited in the MG1 Account; (ii) all expenditures (accrual and cash) that are under the control of the Ministry of Finance (e.g., wages and compensations and transfers to local councils); (iii) all sources of external and domestic financing (e.g., issuances of T-bills, T-notes, promissory notes, loans) and debt services (e.g., interest and coupon payments and amortizations); and (iv) quarterly spending limits and monthly cash releases.	Interconnectedness; internal control over transactions; eliminate unnecessary duplications; achieve comprehensive coverage in IFMIS; reduce vulnerabilities to corruption. Ensure new IFMIS delivers on accountability and efficiency in the execution of PFM reforms.	Met
External sector reform		
RBM to restart scheduled forex purchases via auction to allow for a period of market-price formation. RBM to publish the results and share detailed results with IMF staff.	Deepen the interbank FX market, improve market functioning, efficiency in intermediation with improved liquidity.	Met

Attachment II. Technical Memorandum of Understanding

June 30, 2023

A. INTRODUCTION

1. **This memorandum sets out the understandings between the Malawian Authorities and the International Monetary Fund (IMF) regarding the definitions of the structural benchmarks (SBs), quantitative targets (QTs), and indicative targets (ITs) for the Staff Monitored Program with Executive Board Involvement (PMB) as described in the Memorandum of Economic and Financial Policies (MEFP) for the period November 2022 through November 2023, and sets out the data reporting requirements.** It also describes the methods to be used to assess the program performance and the information requirements to ensure adequate monitoring of the targets. The authorities will inform the Fund before modifying measures contained in this memorandum, or adopting new measures that would deviate from the goals of the program, and provide the Fund with the necessary information for program monitoring.

B. COVERAGE

2. **The government is defined as the budgetary central government of Malawi, extra-budgetary units of the central government, and transfers to local government.** It excludes public nonfinancial corporations, public financial corporations, operations of local councils and social security funds. The budgetary central government is defined as central government entities with budgets controlled by the Ministry of Finance and Economic Affairs (MOFEA).

3. **The coverage of the financial sector includes the Reserve Bank of Malawi (RBM) and other depository corporations (ODC).** Monetary aggregates under the program are based on the central bank survey, other depository corporations survey, and depository corporations survey, in accordance with the Monetary and Financial Statistics (MFS) Manual and Compilation User Guide (2016).

C. PROGRAM EXCHANGE RATES

4. **For the purpose of evaluating the QTs and ITs, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined below, with the exception of items affecting government fiscal balances, which will be measured at the current RBM exchange rates. The program exchange rates are those that prevailed on end-September 2022.** Accordingly, the exchange rates for the purposes of the program are shown in Table 1.

Table 1. Malawi: Cross rates for Nominal Exchange Rate and Gold Price for the 2022 PMB, 2022–23

	30-Sep-22
Gold bullion LBM[1] US$/troy ounce	1660.61
SDR to US$ exchange rate	0.78
Euro to US$ exchange rate	0.97
Yuan to US$ exchange rate	7.10
Yen to US$ exchange rate	144.74
Sterling UK to US$ exchange rate	1.11
Australian $ to US$ exchange rate	0.65
Canadian $ to US$ exchange rate	1.38
Swiss Franc to US$ exchange rate	0.98
Kuwaiti dinar to US$ exchange rate	0.31
Saudi Arabian riyal to US$ exchange rate	3.76
UAE dirham to US$ exchange rate	3.67
South African rand to US$ exchange rate	17.98
Malawian kwacha to US$ exchange rate	1026.4

Sources: IMF (International Financial Statistics); and Reserve Bank of Malawi

[1] LBM connotes London Bullion Market.

D. QUANTITATIVE AND INDICATIVE TARGETS

5. Quantitative Targets are established for December 31, 2022 and June 30, 2023; and Indicative Targets are established for March 31, 2023 and September 30, 2023 with respect to:

- Monetary base (ceiling);
- Domestic revenue (floor)
- Domestic primary balance of the government (floor);
- RBM financing of the central government (ceiling);
- New domestic arrears (ceiling);
- Social spending (floor);
- Change in net international reserves (NIR) of the RBM (floor);
- Accumulation of external payments arrears (ceiling);
- Contracting or guaranteeing of non-concessional external debt (ceiling); and
- Contracting or guaranteeing of concessional external borrowing (ceiling).

E. DEFINITIONS

Targets for Monetary Aggregates

Ceiling on the Stock of Monetary Base

6. A ceiling applies to the upper bound of a monetary base band (set +/-3 percent) around the monetary base target.

7. Definition. The monetary base is defined as currency in circulation, ODCs' deposit holdings at the RBM, and those deposits of money-holding sectors at the RBM that are also included in broad money as defined in the Monetary and Financial Statistics (MFS) Manual and User Guide (2016).

Targets for Fiscal Sector

Floor on Domestic Revenue

8. A floor applies to the cumulative flow of domestic revenue since the beginning of the fiscal year.

9. Definition of domestic revenue: The program domestic revenue is tax and nontax revenue, or other revenue as defined in Government Financial Statistics Manual (GSFM) 2014 Chapter 5, recorded on a cash basis. External loans and grants are excluded. Transfers from extra-budgetary funds, proceeds from the sale of financial assets, revenue from privatizations or from the granting or renewal of licenses, and investment proceeds on government assets are not considered domestic revenue for the purposes of this program.

Floor on Domestic Primary Fiscal Balance

10. A floor applies to the cumulative flow of domestic primary fiscal balance since the beginning of the fiscal year.

11. Definition of the domestic primary fiscal balance. Domestic primary fiscal balance is defined (i) domestic revenue less (ii) the sum of recurrent budget expenditure (net of domestic and foreign interest payments), and domestically-financed budget development expenditure. Those flows related to recapitalization of the RBM are excluded from the calculation of domestic primary fiscal balance.

12. Definition of net foreign borrowing of the government: Net foreign borrowing is defined as the sum of project and program loan disbursements from official creditors (both multi- and bilateral creditors), holdings of government securities by non-residents, and commercial borrowing from non-residents, minus amortization due.

13. Definition of general budget support: General budget support includes all grants and foreign financing not directly linked to externally financed projects. Excluded from this definition are external project financing to fund particular activities, BOP support from the IMF as defined in the Memorandum of Understanding between the MOFEA and RBM, and donor inflows (in kwacha) from the foreign currency-denominated donor pool accounts for the Joint Funds (e.g. health, education, and agriculture), held in financial institutions.

14. Adjustors:

- Adjustor on domestic primary fiscal balance – general budget support: In the event of a general budget support shortfall (or excess), the floor on domestic primary fiscal balance will be adjusted downward (or upward) by the full amount by which the foreign currency-denominated inflows from the general budget support falls short of (or exceed) the program baseline (see Table below). The kwacha value of the cumulative shortfall (or excess) will be calculated at the program exchange rate. General budget support is measured as the cumulative flow from the beginning of the fiscal year.

(USD Millions)	CY2023Q2	CY2023Q3
General budget support	0	0
Multi Donor Trust Fund	0	17

Ceiling on RBM Financing of the Government

15. Definition of RBM financing of the government. RBM financing of the government is defined as gross borrowing from the RBM by the government (including ways and means advances, loans, holdings of local registered stocks, government securities at cost value, and promissory notes) minus government deposits at the RBM. Those flows related to recapitalization of the RBM are excluded from the calculation of RBM financing of the government.

16. Adjustors:

- For cash management purposes, the ceiling on RBM financing of the central government for December 31, 2022; June 30, 2023; and September 2023 is subject to an upward adjustment of up to 10 percent of the average inflation-adjusted (by the GDP deflator) annual domestic revenue of the government for the past three fiscal years.

Ceiling on New Domestic Arrears

17. Definition of domestic arrears: Arrears as defined in PFM Act means all unpaid bills, inclusive of contractual and statutory obligations, after the end of financial year. For the purpose of this TMU, payments on wages and salaries, transfers, and compensations are deemed to be in arrears when they remain unpaid for more than 30 days beyond their due date. Domestic interest payments are in arrears when the payment is not made on the due date. Payments for goods and services are deemed to be in arrears if, following receipt of the goods or services, they have not been made beyond the fiscal year, or – if a grace period has been agreed – within the contractually agreed grace period. For the purpose of the monthly reporting, the outstanding purchase orders, payables, and cash expenses on goods and services will be reported. New pensions arrears are deemed to exist if the stock of pension increases during the end of the fiscal year. For the purpose of the monthly reporting, outstanding pension payments in the last quarter due will be reported.

Floor on Social Spending

18. Definition of social spending. Using functional classification of expenditure, social spending is computed as the sum of central government spending on health, education, and government social protection (comprising the government expenditures by the ministries of health, education, and gender, children, disability and social welfare; National Aids Commission and spending on Affordable Inputs Program (AIP) and maize). To maintain Malawi's commitment and progress toward poverty reduction, the social spending allocations in the government budget will not be adjusted downward to meet fiscal targets of the program.

Targets for External Sector

Floor on Change in Net International Reserves of the RBM

19. Definition of net international reserves (NIR) of the RBM: The Net International Reserve (NIR) of the RBM is defined as reserves assets (RA) of the RBM minus foreign currency drains (FCD) of the RBM. The values of all foreign assets and FCD will be converted into U.S. dollars at each test date using the program cross exchange rates listed in Table 1. Change in NIR on each test date is calculated on a quarterly basis: that is, the change is calculated between the stock of the NIR on the test date and that of the end-date of the previous quarter.

20. Definition of reserve assets of the RBM. are defined by the International Reserves and Foreign Currency Liquidity Guidelines for a Data Template as external assets immediately available and controlled by RBM "for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency's exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing)" (BPM6, paragraph 6.64). Reserve assets include the following: (i) monetary gold holdings of the RBM; (ii) holdings of SDRs; (iii) the reserve position in the IMF; (iv) foreign convertible currency holdings; (v) foreign currency denominated deposits held in foreign central banks, the Bank for International Settlements, and other banks; (vi) loans to foreign banks redeemable upon demand; (vii) foreign securities; and (viii) other unpledged convertible liquid claims on nonresidents.

21. Foreign currency drains (FCD) of the RBM are defined as the sum of the following:

- outstanding medium and short-term liabilities of the RBM (including as an agent of the government), to the IMF. SDR allocations are excluded from foreign currency drains of the RBM; and

- all foreign currency liabilities of the RBM and the RBM as an agent of the government to come due within the next 12 months (4 quarters). These liabilities include (a) all foreign currency debt service falling due in the next 12 months (4 quarters), except to creditors to which the RBM and the RBM as an agent of the government is in arrears and/or servicing via other means, in line with the debt restructuring strategy, and (b) swap outstanding with remaining maturity of less than one year.

22. Adjustors Applied to change in NIR Program Floor:

- **Adjustment clause on NIR- general budget support**: The program floor on change in NIR will be adjusted upward by the full amount by which the foreign currency-denominated inflows from the budget support exceed the program baseline (see Table below). In the event of a shortfall in budget support inflows, the downward adjustment of the change in NIR floor by the full amount by which the foreign currency-denominated inflows from the budget support falls short of the program baseline. They will be recorded in the original currency of payment and then converted to U.S. dollars using the above defined program cross exchange rates.

(USD Millions)	CY2023Q2	CY2023Q3
General budget support	0	0
Multi Donor Trust Fund[1]	0	17

Ceiling on Accumulation of External Payment Arrears

23. Definition of external payment arrears: External payment arrears consist of debt service obligations (principal and interest) of the government or the RBM to nonresidents that have not been paid at the time they are due, or if a grace period has lapsed, as specified in contractual agreements. External debt that is to be subject to rescheduling or restructuring in line with the debt restructuring strategy is exempted from being included as external payment arrears, on the condition that the government continues to make a good faith effort to reach a collaborative agreement. This quantitative target will be monitored on a continuous basis.

Ceiling on Contracting or Guaranteeing Non-Concessional and Concessional External Debt

24. Definition of public and publicly guaranteed debt: The definition of debt, for the purposes of the TMU, is set out in paragraph 8 of the Guidelines on Public Debt Conditionality in

[1] The Multi Donor Trust Fund (MDTF) is used for social projects such as social cash transfer programs. The fund is primarily mobilized in Malawi Kwacha, thus the foreign exchange component is projected to contribute in building up official reserves.

Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), and also includes contracted or guaranteed commitments for which value has not been received. For program purposes, the term "debt" is understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. For program purposes, a debt is considered contracted when all conditions for its entrance into effect have been met, including approval by the National Assembly. Contracting of credit lines with no predetermined disbursement schedules or with multiple disbursements will be also considered as contracting of debt. Debt can take several forms; the primary ones being as follows:

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

- Suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

- Lease agreements, that is, arrangements under which the lessee is allowed to use a property for a duration usually shorter than that of the life of the property in question, but without transfer of ownership, while the lessor retains the title to the property. For the purposes of this guideline, the debt is the present value (at the inception of the lease) of all the lease payments expected for the period of the agreement, except payments necessary for the operation, repair, and maintenance of the property.

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

25. Definition of concessional and non-concessional external debt. Short-, medium-, and long-term debt is considered concessional if it includes a grant element of at least 35 percent[2] and non-concessional if otherwise. The grant element is defined as the difference between the nominal value of the loan (or contractually-agreed package of loans) and its present value, expressed as a percentage of the nominal value of the loan (or package). The present value of the debt at the date on which it is contracted is calculated as the discounted sum of all future debt service payments at

[2] The IMF website gives an instrument (link hereafter) that allows the calculation of the grant element for a wide range of financing packages: http://www.imf.org/external/np/pdr/conc/calculator.

the time of the contracting of the debt.[3] The discount rate used for this purpose is 5 percent per annum. The ceiling on concessional and non-concessional debt applies to the contracting and guaranteeing of debt with nonresidents by the government, the RBM, and state-owned enterprises, unless an explicit selective exclusion is made. This performance criterion is monitored on a continuous basis. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from the beginning of the fiscal year.

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

27. Medium- and long-term debt: Outstanding stock of debt with an original maturity of more than one year.

28. Excluded from the limit on non-concessional external debt is the use of IMF resources.

29. Swaps in debt service: In line with definition of debt (Para.5), debt service payments should include swaps based on the net change in the position.

30. Foreign exchange swaps: contracting or renewing foreign currency swaps with non resident banks beyond the program amount would be subject to the ceiling of non-concessional external debt since they pose fiscal risks.

REPORTING REQUIREMENTS

31. For the purpose of program monitoring, the Government of Malawi will provide the data listed in Table 2 below. For all bi-weekly submissions, data should be reported with a lag of one week. For all monthly and quarterly submissions, data should be reported within 3 weeks. For data submissions requiring audit, data is reported within 10 weeks. Annual data will be provided within six months after the end of the year.

32. The authorities will inform the IMF staff when making any changes in economic and financial policies that could affect the outcome of the financial program. Such policies include, but are not limited to customs and tax laws (including tax rates, exemptions, allowances, and thresholds), development agreements, wage policy, and financial support to public and private enterprises. The authorities will similarly inform the IMF staff of any concessional or non-concessional external debt contracted or guaranteed by the government, the RBM, or any statutory bodies, and any accumulation of new external payments arrears on the debt contracted or guaranteed by these entities.

[3] The calculation of concessionality takes into account all aspects of the loan agreement, including maturity, grace period, schedule, commitment, and management fees commissions.

33. The authorities will furnish an official communication to the IMF describing program quantitative performance, structural benchmarks, and indicative targets within 8 weeks of a test date.

Table 2. Malawi: Summary of Reporting Requirements				
	Frequency of Data[1]	**Frequency of Reporting**[1]	**Frequency of Publication**[1]	**Agency**
Exchange Rates, Spread between exchange bureau midrate and the official exchange midrate	D	2W	D	RBM
Volume of transactions in the interbank money market and Lombard Facility, including banking system liquidity	D	2W	M	RBM
Foreign Exchange Cashflow (including Reserve Assets, Sources and Uses of foreign currency) (Telex Table 14)	D	2W	M	RBM
RBM intervention and ADB's Sales and Purchases of FX	D	2W	M	RBM
Foreign Exchange Swaps	continuous	2W	M	RBM
Reserve/base money, FMO transactions, and RBM conversion of ways and means account to government securities	M	M	M	RBM
Monetary and Financial Statistics Standard Report Forms (1SR, 1SG, 2SR, 2SG, 3SG, 5SR in Telex Table 1)	M	M	M	RBM
Consumer Price Index and monthly statistical bulletin (Telex Table 5)	M	M	M	RBM
Detailed issue and maturity profile for all government securities (Telex Table 6 & 7)	M	M	M	RBM
Central government domestic borrowing (Holdings of local registered stocks, treasury bills, treasury notes and other government securities) (Telex Table 8, 13, 20)	M	M	M	RBM
RBM financing of the central government	M	M	M	RBM
Government Project Funds through the RBM (Telex Table 9)	M	M	M	RBM
Interest rates [2] (Telex Table 12)	M	M	M	RBM
RBM foreign exchange cash flow and intervention (Telex Table 14, 27)	M	M	M	RBM
ADBs FCDA Balances (Telex Table 15)	M	M	M	RBM
Banking System Liquidity (Required and Excess Reserves) (Telex Table 16)	M	M	M	RBM

Table 2. Malawi: Summary of Reporting Requirements (continued)

	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]	Agency
RBM Holding of Treasury Bills and Conversion of Ways and Means Advances (Telex Table 17)	M	M	M	RBM
Reserve Assets of the Monetary Authorities (as defined in Chapter 1 of International Reserves and Foreign Currency Liquidity: Guidelines For A Data Template)[3] (Telex Table 19)	M	M	M	RBM
Foreign Currency Drains of the Monetary Authorities (as defined in Chapter 3 of International Reserves and Foreign Currency Liquidity Guidelines For A Data Template)[3,4] (Telex Table 19)	M	M	…	RBM
Government securities auction results (Telex Table 20)	M	M	M	RBM
Bank statements of the Ministry of Health Swap account, agricultural Swap account, NAC account held at RBM (Table 24, 25, 26)	M	M	…	RBM
Sectoral Allocation of Private Sector Credit (Telex Table 28)	M	M	M	RBM
RBM Foreign Exchange Deposits (Telex Table 32)	M	M	M	RBM
Financial soundness indicators by banks (Telex Table 34)	M	M	…	RBM
Forex Bureau Trade Volume (Telex Table 35)	M	M	M	RBM
Balance of payments	A	A	A	RBM / NSO
New external loans contracted or guaranteed by the government and disbursement schedule[5]	Continuous	Continuous	Continuous	MOFEA
Revenue collected by MRA, by major revenue line	D	2W	M	MOFEA
Accumulation of new domestic government arrears[6]	M	M	M	MOFEA
Strategic Imports (value, volume, and prices)	M	M	M	MOFEA
Fiscal table (GFS based), including revenue, grants, expenditure, balance, and composition of financing of the central government[5, 7]	M	M	…	MOFEA
In-year comprehensive monthly fiscal reports	M	M	Q	MOFEA

Table 2. Malawi: Summary of Reporting Requirements (concluded)

	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]	Agency
Exports and imports of goods and subcomponents (to be added to Telex tables submissions)	M	M	Q	MOFEA
On and off-budget project reports	Q	Q	Q	MOFEA
Stocks of public sector and public-guaranteed debt[5, 8]	Q	Q	Q	MOFEA
Quarterly external debt service (actual and projections)	Q	Q	…	MOFEA
Debt service payments on domestic debt (outturn and projections)	M	Q	Q	MOFEA
Report on IMF program performance	Q	Q	…	MOFEA
Quarterly report on clearance of government domestic arrears	Q	Q	…	AG
Exports and imports of services, and subcomponents.	A	A	A	MOFEA
Annual financial reports of the 5 high-risk parastatals[9]	A	A	…	MOFEA
Consolidated financial statements and audit opinion	A	A	A	AG
Consolidated budget execution reports	M	M	A	AG
GDP/GNP, by activity and expenditure, at constant and current prices	A	A	A	MOFEA

[1] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Semi-annually (SA); Irregular (I).
[2] Both market-based and officially-determined, including discount rates, money market rates, interbank money market rate, rates on treasury bills, notes, and bonds.
[3] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[4] Includes a memorandum section which includes Net International Reserves based as defined in this TMU.
[5] Detailed information on the amounts, currencies, terms and conditions, including debt contracted or guaranteed by the RBM or any other agency on behalf of the central government.
[6] In accordance with the definition of arrears in the TMU Paragraph 17.
[7] Foreign and domestic banks, and domestic nonbank financing.
[8] Includes borrowing of 8 major parastatals: Agriculture Development and Marketing Corporation (ADMARC), Electric Supply Company of Malawi (ESCOM), Electricity Generation Company of Malawi (EGENCO), Malawi Housing Corporation, National Oil Company of Malawi (NOCMA), Northern Regional Water Board, Lilongwe Water Board, and Blantyre Water Board (BWB).
[9] ADMARC, BWB, ESCOM, EGENCO, and NOCMA.

Appendix II. Supplementary Letter of Intent

July 12, 2023

Madame Kristalina Georgieva
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, D.C. 20431
United States

Dear Madame Kristalina Georgieva,

Following the Letter of Intent (LOI) submitted to you on Friday, June 30, 2023, we have submitted to IMF staff revised data for the continuous Quantitative Target (QT) on contracting or guaranteeing of nonconcessional external debt. The Technical Memorandum of Understanding (TMU) under the Staff Monitored Program with Executive Board Involvement (PMB) states that this ceiling is measured cumulatively from the beginning of the fiscal year. Our earlier submission did not include a guarantee that had been extended before the time of the program approval, but still during the FY2022/23 fiscal year. This revision would constitute a breach of the program target which was set at zero for the duration of the PMB.

Going forward, we are fully committed to maintaining an up-to-date, comprehensive repository of sovereign guarantees and underlying contracts at the Department of Debt and Aid at Ministry of Finance and Economic Affairs (MOFEA). We are also fully committed to maintaining an up-to-date comprehensive repository of guarantees (including foreign currency payment guarantees) and underlying contracts at the Financial Market Department of the Reserve Bank of Malawi (RBM). As MOFEA is responsible for submitting data on *New external loans contracted or guaranteed by the government and disbursement schedule* (per TMU Table 2), MOFEA will coordinate with the RBM to ensure the accuracy of reporting to IMF staff on a continuous basis.

We reiterate that we are confident that, through the implementation of measures and policies described in the MEFP submitted to you on June 30, 2023, we will attain the objectives of the PMB.

Yours sincerely,

/s/	/s/
Honorable Sosten Alfred Gwengwe	Dr. Wilson T. Banda
Minister of Finance and Economic Affairs	Governor of the Reserve Bank of Malawi

Attachment:

1. Revised Table 1 of the Memorandum of Economic and Financial Policies

Attachment I. Revised Table 1. Malawi: Quantitative and Indicative Targets[1], 2022–23

	Target type [2]	2022				2023					
		End-Dec.				End-Mar.				End-Jun.	End-Sep.
			Adjusted				Adjusted			Proposed	
		QT	QT	Est.	Status	IT	IT	Est.	Status	QT	IT
I. Monetary targets (billions of kwacha)											
Monetary base (ceiling on stock) (upper bound)[3]	QT	590.2				607.6		578.5		633.3	685.6
Monetary base (ceiling on stock)[3]		573.0		570.9	met	589.9		561.7	met	614.9	665.6
Monetary base (ceiling on stock) (lower bound)[3]		555.8				572.2		544.8		596.4	645.6
II. Fiscal targets (billions of kwacha)											
Domestic revenue (floor)[6]	IT	1,202.7		1,230.6	met	1,603.5		1,658.5	met	418.1	834.6
Domestic primary fiscal balance (floor)[4,6]	QT	-17.1	-36.2	-198.8	not met	-70.0		-304.4	not met	-7.4	-83.0
RBM financing of central government (ceiling)[6,7]	QT	0.0	158.2	215.9	not met	0	158.2	212.2	not met	0	0
New domestic arrears (ceiling)[6]	IT	0.0		n.a.	n.a.	0		148.3	not met	0	0
Social spending (floor)[6,8]	IT	503.7		610.4	met	669.3		868.1	met	203.2	409.8
III. External sector targets (US$ millions, unless otherwise indicated)											
Change in net international reserves of the RBM (floor)[5]	QT	141.3	122.7	116.0	not met	7.0	-23.8	-16.3	met	87.9	150.4
Accumulation of external payments arrears (ceiling)[6,9]	QT	0		0	met	0		0	met	0	0
Contracting or guaranteeing of nonconcessional external debt (ceiling)[6,9,10]	QT	0		50	not met	0		50	not met	0	0
Contracting or guaranteeing of concessional external debt (ceiling)[6]	IT	15		284	not met	30		284	not met	0	0
Memorandum items:											
Program exchange rate (kwacha per US$)		1,026.4		1,026.4		1,026.4				1,026.4	1,026.4

Source: IMF staff projections.

[1] Targets are defined in the technical memorandum of understanding (TMU).

[2] "QT" means Quantitative Target and "IT" means Indicative Target. The QT test date for the 1st Review is end-December 2022. Test dates for future reviews will be end-June 2023. End-March and end-September 2023 targets are ITs.

[3] QT applies to upper bound only. See TMU for details.

[4] Targets are subject to an adjustor for general budget support, as specified in the TMU.

[5] Targets are subject to an adjustor for (i) debt service and fees and (ii) general budget support, as specified in the TMU.

[6] Defined in nominal terms as a cumulative flow, starting from the beginning of the fiscal year. Note that targets for end-December 2022 and end-March 2023 were set from the beginning of the prog

[7] Targets are subject to an adjuster equivalent to 10 percent of the average of the inflation adjusted domestic revenues of the previous three fiscal years, as specified in the TMU.

[8] Priority social spending as defined in the TMU and quantified in the authorities' budget.

[9] Evaluated on a continuous basis.

[10] For program purposes, a limited exception on NCB may be allowed only in the exceptional circumstance that it is used to wind down maturing swaps and for debt management operation that improves the overall debt profile.

INTERNATIONAL MONETARY FUND

MALAWI

July 13, 2023

FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM WITH EXECUTIVE BOARD INVOLVEMENT—DEBT SUSTAINABILITY ANALYSIS

Approved By
Costas Christou and Bjoern Rother (both IMF) and Manuela Francisco and Asad Alam (both IDA)

Prepared by the International Monetary Fund and the International Development Association[1]

Malawi: Joint Bank-Fund Debt Sustainability Analysis[2]	
Risk of external debt distress	*In Debt Distress*
Overall risk of debt distress	*In Debt Distress*
Granularity in the risk rating	*Unsustainable*
Application of judgment	*No*

Malawi's external and overall public debt is assessed as "in distress"—unchanged from the previous Debt Sustainability Analysis (DSA) in November 2022, given the deteriorating macroeconomic outlook and lack of progress on debt restructuring. This DSA presents an analysis of Malawi's debt outlook prior to the implementation of the authorities' planned external debt restructuring.

Under the baseline scenario, the Present Value (PV) of PPG external debt-to-GDP ratio remains below the threshold throughout the horizon. However, breaches are observed in the PV of debt-to-exports, debt service-to-exports, and debt service-to-revenue ratios over the medium term—with significant external debt servicing needs (around 60 percent of exports in 2023) falling due in the near term. The debt service-to-exports ratio remains in breach beyond the medium-term horizon. The PV of Malawi's overall public debt-to-GDP was around 67 percent in 2022 and remains significantly above the threshold through the medium term. Malawi's debt is currently unsustainable. Timely and complete implementation of the authorities' debt restructuring strategy would be required for the external debt burden to be considered sustainable on a forward-looking basis.

[1] The current DSA follows the revised Debt Sustainability Framework (DSF) for LICs and Guidance Note (2017) in effect as of July 1, 2018.

[2] Malawi's Composite Indicator (CI) is based on the latest published vintage (2021 Country Policy and Institutional Assessment, CPIA) and the IMF's April 2023 World Economic Outlook. The CI remains 'weak' with a CI score of 2.42.

PUBLIC DEBT COVERAGE

1. **The DSA covers central government debt, central government guaranteed debt, and central bank debt contracted on behalf of the government** (Text Table 1). Public debt used for this DSA is public and publicly guaranteed (PPG) external (as defined on a residency basis) and public domestic debt, covering debt contracted and guaranteed by the central government and the Reserve Bank of Malawi (RBM). Due to data limitations, it does not include debt held by state and local governments, other elements in the general government (such as the social security fund and extra budgetary funds), or nonguaranteed state-owned enterprise (SOE) debt. [3,4]

Text Table 1. Malawi: Coverage of Public Sector Debt, 2022

	Subsectors of the public sector	Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

1	The country's coverage of public debt	The central government, central bank, government-guaranteed debt			
		Default		Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0	percent of GDP	4.0	Limited coverage, 0.6 percent for contingent liabilities due to swaps, 1.3 percent for government guaranteed debt.
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	2.0	
4	PPP	35	percent of PPP stock	0.0	
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	
	Total (2+3+4+5) (in percent of GDP)			11.0	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

BACKGROUND AND RECENT DEVELOPMENTS

2. **This DSA is being conducted in the context of the first review of the Staff-Monitored Program with Executive Board Involvement (PMB).** The last Low-Income Country (LIC) DSA using the LIC-Debt Sustainability Framework (DSF) was considered by the Executive Board in November 2022 as part of the request for disbursement under the Rapid Credit Facility and request for a PMB.[5] Malawi is subject

[3] The contingent liabilities shock from SOE debt is kept at the default value of 2 percent to reflect risks associated with nonguaranteed SOE debt, currently excluded from the analysis due to data availability constraints. There are no current public-private partnerships reported that subject the authorities to contingent liabilities.

[4] The government has recognized the importance of increasing debt coverage and requested the World Bank to support in creating a contingent liability framework under the FY24 SDFP.

[5] The last joint DSA can be found in IMF Country Report No. 22/352, November 2022.

to International Development Association (IDA)'s Sustainable Development Finance Policy (SDFP) and the IMF's Debt Limit Policy (DLP), which both impose a zero non-concessional debt ceiling.

3. **Malawi has been affected by a series of shocks since the approval of the PMB, including an outbreak of cholera and Cyclone Freddy.** Real GDP growth in 2022 decelerated sharply to 0.8 percent, as projected in the PMB, from the revised official rate of 4.6 percent in 2021. This reflected two tropical storms that hit Malawi in the first quarter of 2022, interruptions to electricity supplies due to damaged turbines, shortened 2021/22 agricultural season rains, and spillover effects from Russia's invasion of Ukraine through higher fuel, fertilizer, and food prices. From late 2022 to early 2023, Malawi experienced its worst outbreak of cholera in decades, forcing the closure of schools and businesses. Then, in the first quarter of 2023, southern Malawi was hit by Cyclone Freddy, resulting in a significant death toll, the destruction of critical infrastructure, and agriculture production losses.

4. **In this context, inflation has been roughly the same as expected for end-2022.** Average inflation was 20.8 percent in 2022, up from 9.3 percent in 2021. However, inflation (y-o-y) continues to rise and reached 29.3 percent in May 2023. Inflation was driven by both food and nonfood items, reflecting passthrough from a 25-percent currency devaluation in May 2022, high global prices for fuel, fertilizer, and food, and prolonged supply disruptions. In April 2023, the RBM raised the policy rate to 22 percent, from 18 percent, to signal its policy stance. Money growth, which has also been fueling inflation, has begun to decelerate, but achieving price stability will also require reducing the fiscal deficit and related government borrowing, which has been driving money creation and crowds out private sector access to financing.

5. **The fiscal deficit in FY22/23 (April/March) was larger than expected at the time of the PMB.** Revenue came in higher than expected, reflecting larger project grants to help Malawi cope with the series of shocks, but expenditure overruns were even larger, reflecting higher spending needs associated with higher food, fuel, and fertilizer prices, the cholera outbreak, and Cyclone Freddy. The previously budgeted expenditures took longer to slow than anticipated due to weaknesses in public financial management (PFM). In addition, the May 2022 currency devaluation gave rise to losses at the RBM, due to its net-negative foreign asset position. By law, the government was required to recapitalize the RBM at the end of the calendar year, which increased government capital transfers by 1.4 percentage points of GDP. As a result, the overall deficit reached 11.8 percent of GDP, compared with 9.0 percent projected at the time of the PMB. The domestic primary deficit was 3.8 percent of GDP compared with the PMB's 0.6 percent.

6. **Meanwhile, external strains—including shortages of foreign exchange, difficulties in securing trade credit, and a widening spread between official and bureau exchange rates—have heightened.** A sharp contraction in reported imports reduced the current account deficit to 3.2 percent of GDP in 2022, much narrower than the 14.8 percent of GDP projected at the time of the PMB and the 14.1 percent of GDP outturn in 2021. This is consistent with the depreciation of the exchange rate and reported difficulties in acquiring foreign exchange. But it is also likely to reflect an increase in informal imports (corroborated, for example, by the large discrepancy between fuel imports data from the customs authority and other sources), in the context of stigma associated with transacting away from the official exchange rate. Notwithstanding this uncertainty in relation to the accuracy of the official data (which are still subject to revision), anecdotal accounts provided by the authorities and others do support the notion that the cost

and difficulty of securing foreign currency have weighed on private sector consumption and investment in some sectors of the economy.

7. Despite the sharp reduction in the current account deficit, FX reserve accumulation has been slower than expected. As of end-2022, gross official reserves stood at 1% of GDP. This is consistent with foreign currency leaving the country via informal imports, as described above, or other outflows of capital. The RBM has struggled to accumulate reserves, despite the imposition of surrender requirements on exporters, in part reflecting pressure to provide foreign exchange to meet demand from importers following a withdrawal of international banks confirming letters of credit (LCs), particularly for fuel and other strategic imports. In addition, rollover risks of the RBM's foreign currency swaps materialized near the end of 2022, and the stock of foreign exchange reserves thus remained low. In June 2023, the RBM restarted FX auctions to facilitate price discovery for the exchange rate.

8. The authorities continue to pursue the external debt restructuring strategy announced last year, which staff assesses to represent a challenging but credible path to external debt sustainability. Nevertheless, risks have increased since the time of the PMB request. Malawi remains in negotiations with its commercial and official bilateral creditors. If completed in a timely manner, the proposed strategy would lower Malawi's risk of external debt distress to moderate in the medium term through a substantial reduction in the net present value (NPV) of the debt and of the short and medium-term debt servicing needs (Box 1).

Box 1. Malawi: October 2022 Debt Restructuring Strategy

The authorities have announced a debt restructuring strategy which will serve as the cornerstone for restoring debt sustainability. This follows a decade in which Malawi's external debt (as a share of GDP) has increased by over 80 percent, leading to an unsustainable debt burden and servicing costs. In May 2022, they hired legal and financial advisors to support a credible process for restructuring based on adequate creditor engagement to ensure the approach taken delivers the necessary contributions in a sustainable manner. The authorities approached all external creditors early in the process.

The debt restructuring strategy is designed to achieve debt sustainability and to close the financing gaps. The strategy relies on the following pillars to overcome current external debt challenges, including solvency and liquidity concerns:

- Bringing external public debt back to a moderate risk of debt distress in the medium term through a combination of policy adjustment and the necessary debt treatment. The debt strategy is designed to ensure all external DSA solvency and liquidity ratios move below their respective thresholds under the baseline over the medium term. As such, the present value of debt-to-GDP ratio falls below 30 percent, the present value of debt-to-exports ratio falls below 140 percent, the debt service-to-exports ratio falls below 10 percent, and the debt-to-revenue ratio falls below 14 percent in the medium term (see chart panel below).

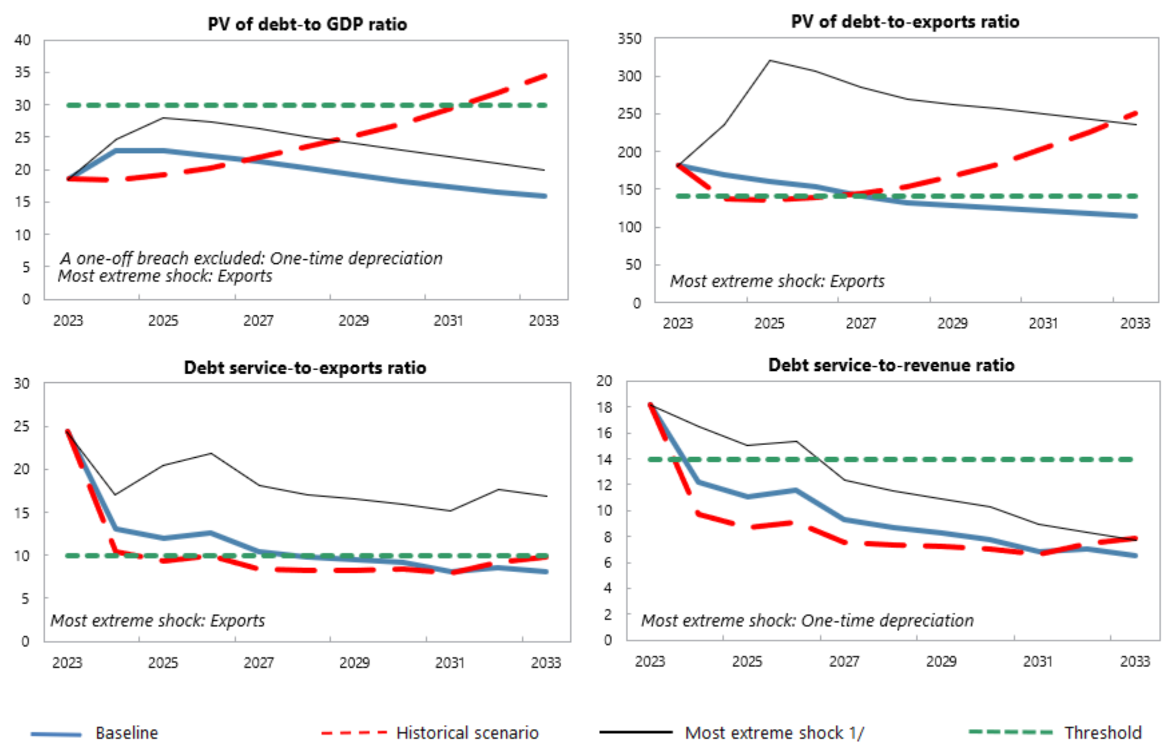
- Mobilization of non-debt-creating flows to ensure that external and fiscal financing gaps are closed over the program period, including through the debt treatment and the mobilization of external grant support from development partners.

Box 1. Malawi: October 2022 Debt Restructuring Strategy (concluded)

- The corresponding NPV debt reduction sought at the time of the PMB was US$579 million. This would be achieved via significant maturity extension and reprofiling of scheduled payments so as to provide important near-term liquidity relief and to bring Malawi's external debt servicing costs in the medium term to a sustainable level.

The authorities remain in negotiations with commercial and official bilateral creditors, but progress has been slow to date. Malawi continues to run arrears vis-à-vis Trade and Development Bank (TDB), as agreed by both parties to facilitate negotiations, while it remains current on its obligations towards AFREXIM Bank and its official creditors (Text Table 2).[1] In conjunction with their debt advisors, Malawi is in the process of obtaining financing assurances in line with the restructuring strategy and the parameters of the PMB. The timeline to complete this process remains uncertain, but the authorities are hopeful of progress in the coming months.

Indicators of Public and Publicly Guaranteed External Debt Under Post-Debt Restructuring Scenario, 2023–33



1/ The most extreme stress test is the test that yields the highest ratio in or before 2033.

[1] TDB and Afrexim Bank are classified as commercial creditors as per the guidelines set out in the IMF's 'Reviews of the Fund's Sovereign Arrears Policies and Perimeter' (May 2022).

Text Table 2. Malawi: Decomposition of Public Debt and Debt Service by Creditor, 2022–2024[1]

	Debt Stock (end of period)			Debt Service			
	2022			2023	2024	2023	2024
	(In Million US$)	(Percent total debt)	(Percent GDP)	(In Million US$)		(Percent GDP)	
Total	8,642	100	75	2,347	1,892	20	19
External	3,949	46	34	791	366	7	4
Multilateral creditors[2]	2,559	30	22	100	119	1	1
IMF	438	5	4	39	41	0	0
World Bank	1,318	15	11	33	44	0	0
AfDB	432	5	4	8	11	0	0
Other Multilaterals	372	4	3				
o/w: IFAD	106	1	1	4	4	0	0
OFID	76	1	1	10	10	0	0
Bilateral Creditors	418	5	4	44	40	0	0
Paris Club	4	0	0	3	0	0	0
o/w: Spain	3	0	0				
Belgium	1	0	0				
Non-Paris Club	414	5	4	41	40	0	0
o/w: EXIM China	222	3	2	21	21	0	0
EXIM India	114	1	1	14	13	0	0
Saudi Arabia	29	0	0	1	2	0	0
Local debt with non-residents	87	1	1	11	19	0	0
Commercial creditors	832	10	7	608	166	5	2
o/w: AFREXIM	495	6	4	237	166	2	2
TDB	337	4	3	371	0	3	0
FX Swaps with non-residents	53	1	0	27	22	0	0
Domestic	4,693	54	41	1,556	1,526	19	15
Held by residents, total	4,555	53	40	1,545	1,515	19	15
FX Swaps with resident	139	2	1	11	11	0	0
Memo items:							
Collateralized debt[3]	508	6	4				
o/w: Related							
o/w: Unrelated		0	0				
Contingent liabilities	53	1	0				
o/w: Public guarantees		0	0				
o/w: Other explicit contingent liabilities[4]							
Nominal GDP	12,534						

1/As reported by country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA.

2/Multilateral creditors are defined here as institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears)

3/Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion

4/Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

UNDERLYING ASSUMPTIONS

9. Financing assumptions rest on the implementation of a strict reform program by the authorities while debt restructuring negotiations are ongoing. Under the PMB, the authorities committed to a macroeconomic adjustment and reform program to restore macroeconomic stability and promote durable and inclusive growth, and to establish a track record to support a request for an ECF arrangement. Moreover, decisive actions to secure financing and debt sustainability assurances are envisaged in the authorities' debt restructuring strategy (Box 1), which includes the replacement of non-concessional external financing by non-debt-creating flows (including grants and debt relief).[6]

10. The key macroeconomic assumptions have been updated from the DSA that accompanied the PMB request (the November 2022 DSA hereafter). The baseline scenario presented here is in line with the macroeconomic adjustment path envisaged under the PMB and is intended to represent a pre-debt restructuring scenario (Text Table 3). Changes to the underlying assumptions relative to the November 2022 DSA are as follows:

- **Growth** is weaker in the near term, reflecting the hit to activity associated with Cyclone Freddy, particularly on the agricultural sector, and the impact of foreign exchange shortages and other external shocks. Real GDP growth is now projected to be 1.7 percent in 2023, down from 2.4 percent projected at the time of the PMB, before recovering to 4.6 percent in the medium term in line with the PMB. This is underpinned by gradual macroeconomic stabilization and a recovery across all sectors, including the resumption of electricity generation at the Kapichira hydropower plant, which will support the manufacturing sector. The long-term growth assumptions incorporate the expected impact of future weather-related shocks, given Malawi's vulnerability to climate change.

- The outlook for **inflation** has similarly worsened, despite some easing in global price pressures. CPI inflation is projected to reach 24.8 percent in 2023, up from 22.7 percent as expected at the time of the PMB. In the medium term, inflation returns to around 6.5 percent as external shocks fade and money growth is brought under control. Monetary policy is assumed to remain tight, with **broad money growth** in line with nominal GDP.

- The baseline scenario includes a challenging **fiscal adjustment**. It aims to, at a minimum, stabilize public debt by the end of medium term—i.e. to reduce the primary deficit, preliminarily estimated at 4.6 percent of GDP in 2022, to sustainably reach the debt-stabilizing primary deficit by 2028 at the latest. Accordingly, the size of fiscal adjustment in terms of **domestic primary balance** is set at about 1½ percentage point of GDP per year—which is within the norm of fiscal adjustments for fragile states and is consistent with policy adjustments identified in recent Technical Assistance on domestic revenue mobilization. The adjustment on expenditure will focus on scaling back the Affordable Input Programme (fertilizer subsidies) by improving targeting and efficiency, and reallocation of spending towards building a foundation for growth and boosting human and physical capital, including

[6] Consistent with the LIC DSF Guidance Note, grants are only included in the DSA if they are firmly committed or, if they don't change the risk of debt distress rating, where they are considered highly likely.

improvements in the social safety net. This is supported by the introduction of new revenue measures as well as improvements in tax administration.

- The baseline scenario assumes that the RBM takes decisive steps to rebuild **gross official reserves,** which increase to a level better able to withstand external shocks (assessed to be at least four months of imports cover) as soon as possible but no later than by the end of the medium term. This will require the central bank to reduce sales of foreign exchange to the market and move quickly to being a consistent net buyer.

Text Table 3. Malawi: Underlying DSA Assumptions, 2019–28

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	Avg. 2028-43
					(year-on-year percent change)						
Real GDP Growth											
Current	5.4	0.9	4.6	0.8	1.7	3.3	3.8	4.3	4.5	4.6	4.6
Previous	5.4	0.9	2.2	0.8	2.4	3.2	3.8	4.3	4.5	4.6	...
					(Percent of GDP)						
Primary Balance[1/]											
Current	-1.9	-2.7	-3.6	-5.0	-6.8	-4.9	-1.6	1.2	1.5	2.1	2.2
Previous	-1.9	-2.7	-3.7	-5.4	-3.3	-1.7	-0.2	0.7	0.8	1.4	...
Total Public Debt[1/]											
Current	45.3	54.8	61.5	75.2	80.2	80.2	80.9	79.6	78.1	75.1	54.1
Previous	45.3	54.8	64.0	76.6	74.6	74.5	73.8	72.6	71.0	68.9	...
Current Account Deficit											
Current	12.6	13.8	14.1	3.2	7.9	9.0	8.6	7.6	6.3	5.9	3.8
Previous	12.6	13.6	14.6	14.8	13.6	14.3	13.1	11.2	9.6	9.0	...
FDI											
Current	1.0	0.8	0.8	0.3	0.4	0.5	0.8	0.9	0.9	1.0	1.3
Previous	1.0	0.8	0.7	0.8	0.9	1.2	1.3	1.4	1.5	1.6	...

Sources: Malawian authorities and IMF staff calculations and projections.

[1/] Fiscal Data refers to fiscal year; e.g. 2021 = FY2020/21

- The **current account deficit** is projected to widen in the coming years as imports rebound (and informal imports reduce), before improving gradually over the medium term. The current account balance reaches around 6 percent of GDP in 2028, relative to 9.5 percent of GDP at the time of the PMB, reflecting the fact that not all the squeeze experienced in 2022 unwinds over this horizon. Within this, **exports of goods and services** increases from 9 percent of GDP in 2022 to 15.3 percent of GDP in 2028, roughly in line with the PMB over the medium term. The external sector adjustment will be supported by efforts to boost exports, including government measures to promote agriculture commercialization through supporting small farmers and attracting large anchor firms, as well as expanding mining activity.

- The total **external financing gap** (from 2023 to 2028) is projected to amount to around $1.5 billion (roughly 12 percent of 2022 GDP). The assumed financing mix and terms for the government are in line with Malawi's Medium-Term Debt Management Strategy (MTDS), as in the November 2022 DSA.[7] The cost of domestic financing is assumed to decrease gradually over the medium term, as monetary policy normalizes and the outlooks stabilizes, with issuance across the curve but predominantly at maturities between two and five years. No debt treatment is assumed in the baseline scenario; instead, net domestic financing is assumed to fill the residual gap on market terms in the baseline scenario. Non-concessional external financing is wound down over time, with prospective concessional budget support grants and loans assumed to come in CY2023 Q4. In the medium term the external debt stock is smaller as a share of GDP and largely composed of financing from multilateral creditors.

REALISM OF THE BASELINE ASSUMPTIONS

11. **The realism tools suggest that the baseline scenario is not significantly out of line with Malawi's historical experience and cross-country experiences** (Figures 3 and 4). The projected trajectory of nominal external and overall public debt as a share of GDP is broadly similar to that in the November 2022 DSA. Absent restructuring, the growth of external debt is slightly lower over the next five years than in the preceding five years, partly reflecting the improvement in the current account balance. Overall public debt is projected to grow by notably less, given the assumed fiscal adjustment.

12. **The pace of adjustment in the primary balance in the next three years is ambitious and falls within the top quartile of historical data on LIC adjustment programs** (Figure 4). The GDP growth projection is also stronger than implied by the estimated fiscal impulse alone, given staff expects some catch-up growth as Malawi recovers from the impact of Cyclone Freddy and other supply shocks, as well as the positive catalytic effects of the assumed reform path. These results highlight the challenging nature of the adjustment path and support the assessment in the Staff Report that the balance of risks is tilted to the downside.

COUNTRY CLASSIFICATION AND MODEL SIGNAL

13. **Malawi's debt-carrying capacity based on the Composite Indicator (CI) is assessed as weak** (Text Table 4). The CI is determined by the World Bank's 2021 Country Policy and Institutional Assessment (CPIA), the IMF's April 2023 World Economic Outlook, and other variables informed by the macroeconomic framework, including real GDP growth, import coverage of reserves, remittances as a percent of GDP, and global growth. The four external debt burden thresholds and the total public debt benchmark are determined by this classification of the debt carrying capacity (Text Table 5).

[7] Updated IDA disbursement projections (June 26, 2023) with additionality of $38mn, $13mn, $49mn, $30mn and -$39mn in 2023 through 2027, respectively, are not reflected in this. These data include maturing of operations committed during previous IDA cycles and a proactive strategy by the World Bank to fast-track implementation of projects and will not materially alter the impact on the DSA solvency and liquidity indicators, given the concessional nature of this financing.

Text Table 4. Malawi: Composite Index

Debt Carrying Capacity	Weak

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Weak	Weak	Weak	Weak
	2.42	2.27	2.34

Calculation of the CI Index:

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.147	1.21	50%
Real growth rate (in percent)	2.719	3.432	0.09	4%
Import coverage of reserves (in percent)	4.052	21.568	0.87	36%
Import coverage of reserves^2 (in percent)	-3.990	4.652	-0.19	-8%
Remittances (in percent)	2.022	2.223	0.04	2%
World economic growth (in percent)	13.520	2.856	0.39	16%
CI Score			2.42	100%
CI rating			Weak	

Text Table 5. Malawi: Debt Carrying Capacity and Thresholds

EXTERNAL debt burden thresholds	Weak	Medium	Strong
PV of debt in % of			
Exports	140	180	240
GDP	30	40	55
Debt service in % of			
Exports	10	15	21
Revenue	14	18	23

EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	140
GDP	30
Debt service in % of	
Exports	10
Revenue	14

TOTAL public debt benchmark	
PV of total public debt in percent of GDP	35

SCENARIO STRESS TESTS

14. Standard scenarios stress test and a contingent liability stress test are conducted (Text Table 1, and Tables 3 and 4). The latter features a one-off increase of 11 percentage points in the debt-to-GDP ratio in the second year of the projection, designed to capture the combined impact of limited public debt coverage, contingent liabilities relating to foreign exchange swaps, contingent liabilities associated with SOEs, and potential future bank recapitalization needs.

15. A second tailored scenario featuring a commodity price shock is also conducted (Tables 3 and 4). Given that tobacco accounts for nearly half of Malawi's total goods exports, the DSA stress tests the debt outlook against a prolonged decline in commodity prices. The shock is calibrated to simulate a decline in prices in the second year of the projection to the lower end of the 68 percent confidence interval in the IMF's commodity price forecasts, which is then assumed to unwind over a period of six years.

EXTERNAL DSA

16. Malawi's external public debt is assessed to be in debt distress, reflecting the country's ongoing debt restructuring negotiations. Under the baseline scenario, the PV of PPG external debt-to-GDP ratio remains below the threshold. But there are significant and sustained breaches of the other solvency and liquidity indicators (Figure 1). The PV of debt-to-exports, debt service-to-exports, and debt service-to-revenue ratios are currently above their respective thresholds and remain so for a prolonged period—through 2029 in the case of debt-service-to-exports. The debt service burden is exceptionally high in the near-term, reaching 60 percent of exports and 45 percent of revenue in 2023.

17. Malawi's external debt is currently unsustainable. If the debt restructuring strategy were to be executed successfully, alongside implementation of the envisioned macroeconomic adjustment, it would be considered sustainable on a forward-looking basis. A successful debt treatment of commercial and official bilateral debt in line with the authorities' strategy (as set out in Box 1) would significantly reduce near-term debt service and bring the relevant solvency and liquidity indicators below their respective thresholds by 2028 or sooner. This would bring Malawi back to moderate risk of external debt distress over the medium term.

18. The stress scenarios highlight that Malawi's capacity to service its debt is particularly sensitive to the outlook for exports and the exchange rate. Malawi's exports are highly concentrated and vulnerable to weather and climate-related shocks, while the exchange rate could also be buffeted by domestic and external shocks. Mitigating the former risk somewhat is the fact that Malawi has typically received steady and predictable aid flows in foreign currency (not accounted for in the calculation of the DSA's liquidity indicators).

PUBLIC DSA

19. Malawi's overall public debt is assessed to be in distress, given the ongoing external debt restructuring negotiations, and fiscal slippages have added to the increasing risks stemming from domestic debt. Under the baseline scenario, the PV of overall public debt reaches 68.8 percent of GDP in 2023, significantly above the threshold of 35 percent. This indicator declines somewhat over the medium term but remains in breach. Overall public debt service peaks in 2025 at 147 percent of revenues and remains high in the medium term. Successful implementation of the government's external debt restructuring strategy would significantly reduce the PV and servicing costs of overall public debt, although both would remain elevated, albeit decreasing, in the medium term. The overall risk of public debt distress would remain high in this scenario.

RISK RATING AND VULNERABILITIES

20. Malawi is currently in debt distress, but conditional on the successful completion of the government's debt restructuring strategy, its external debt would be considered sustainable on a forward-looking basis. Absent restructuring the debt burden is assessed to be unsustainable, given the vulnerabilities associated with the significant and sustained breaches of the DSA's solvency and liquidity indicators.

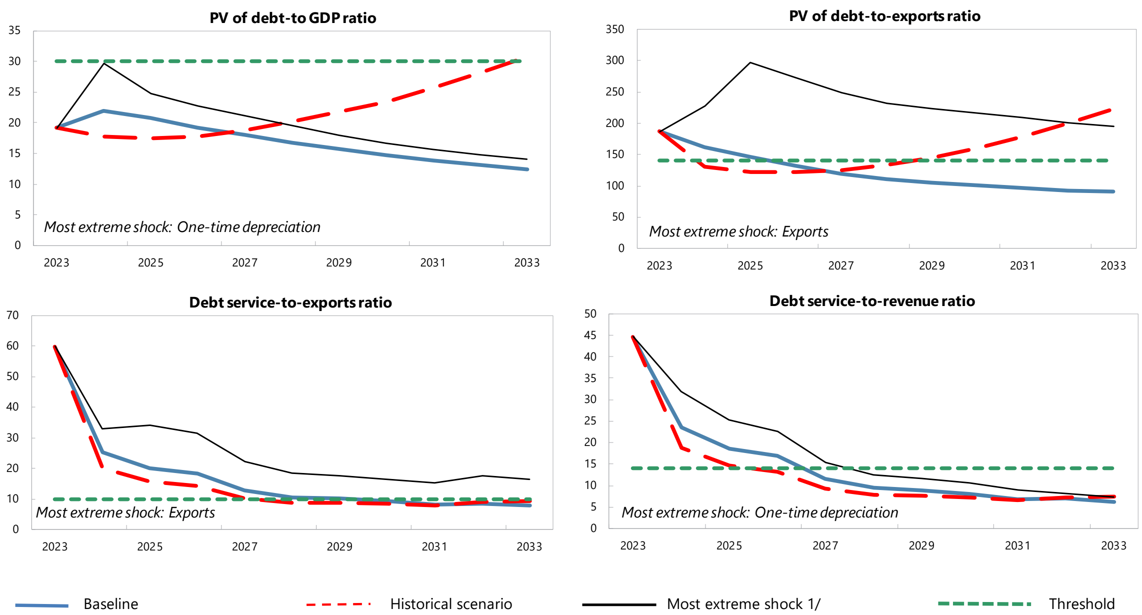
21. This assessment is subject to significant risk and uncertainty. Most notably, slow progress on the completion of Malawi's debt restructuring strategy will make it increasingly difficult to close the government's financing gaps the longer negotiations continue. Likewise, there is limited room for any further slippage on the ambitious fiscal adjustment, and associated implementation of public financial management measures, envisioned as part of the PMB. Malawi is also vulnerable to a range of external shocks and will remain even more so if the authorities fail to rebuild external buffers. The level of foreign exchange reserves is now historically low.

22. Mitigating factors include the authorities' strong commitment to macroeconomic adjustment, including corrective actions to complete the first review of the PMB. Expedited and comprehensive implementation of necessary policy actions has the potential to catalyze a positive feedback loop: as the outlook improves, resilience is strengthened, and confidence is boosted. Further upside risks include successful efforts to pursue export diversification, including sooner-than-expected development of mining projects, which would enhance Malawi's capacity to meet future debt servicing needs.

AUTHORITIES' VIEWS

23. The authorities are in broad agreement with the WB's and IMF's staff assessments. They remain determined to take bold policy action and to build a track record to support a future application for a UCT-quality Fund program. This will include strong corrective actions as necessary to ensure the PMB remains on track. Restoring macroeconomic stability will require political commitment to strong fiscal and external adjustment, as well as meaningful debt relief as set out in the authorities' external debt restructuring strategy.

Figure 1. Malawi: Indicators of Public and Publicly Guaranteed External Debt Under Baseline (Pre-Debt Restructuring) Scenarios, 2023–33



Customization of Default Settings	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	n.a.	n.a.
Commodity price 2/	No	No
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	0.7%	0.7%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	34	34
Avg. grace period	6	6

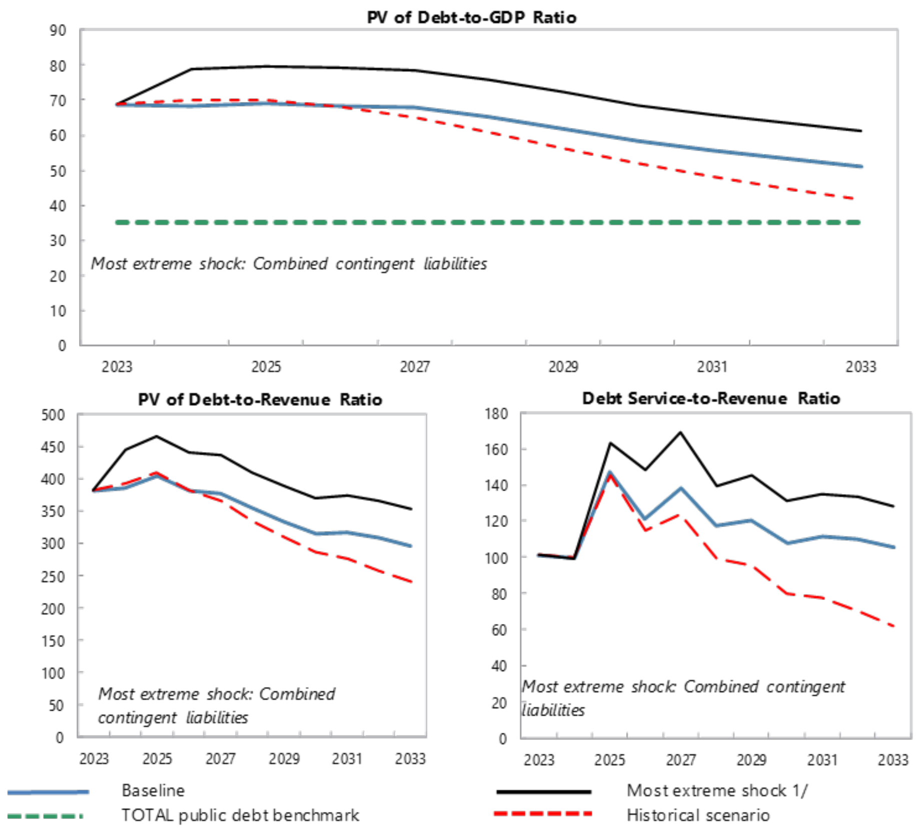
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2033. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Malawi: Indicators of Public Debt Under Baseline Scenarios, 2023–33



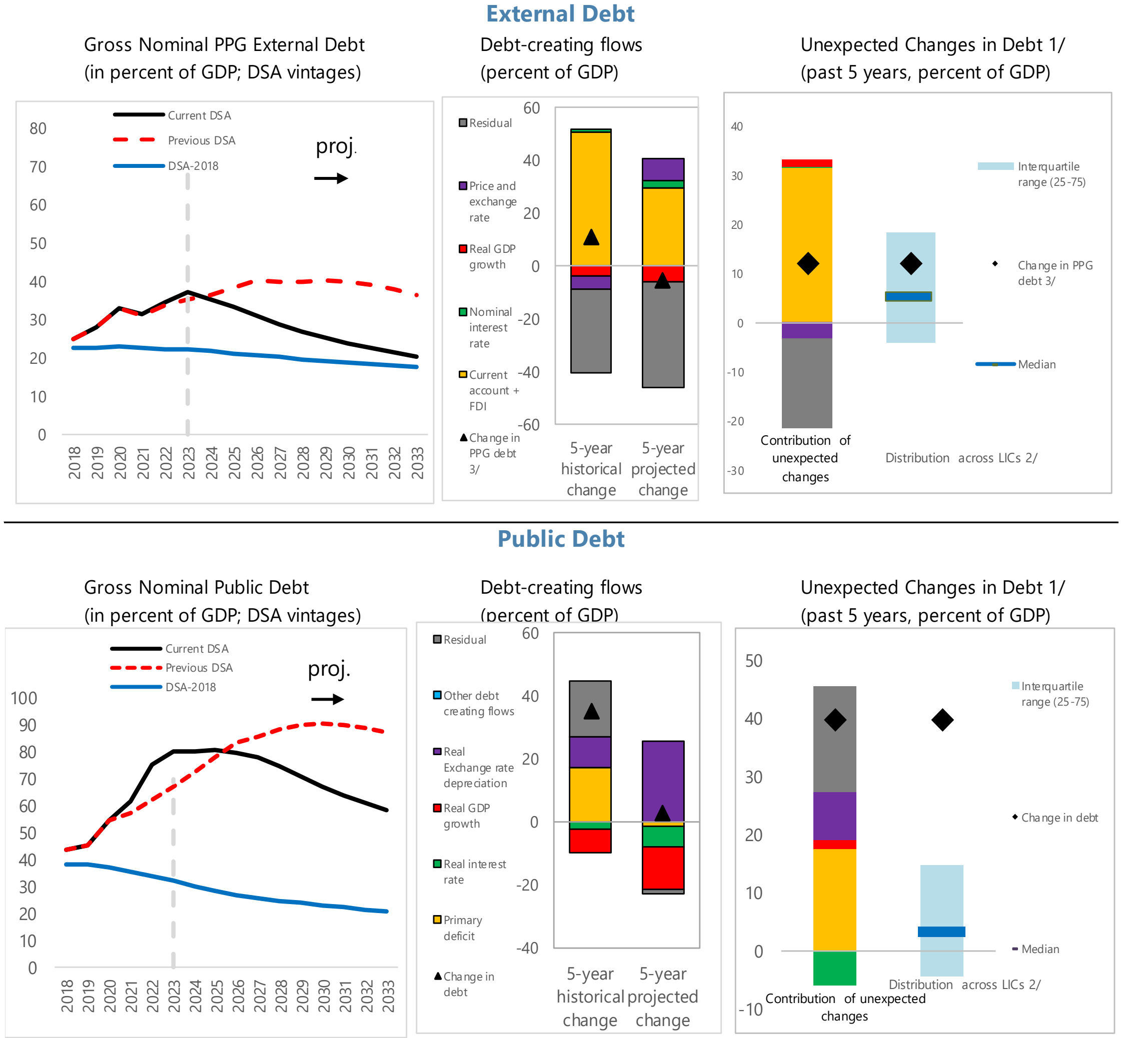
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	8%	8%
Domestic medium and long-term	78%	78%
Domestic short-term	14%	14%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	0.7%	0.7%
Avg. maturity (incl. grace period)	34	34
Avg. grace period	6	6
Domestic MLT debt		
Avg. real interest rate on new borrowing	5.8%	5.8%
Avg. maturity (incl. grace period)	3	3
Avg. grace period	1	1
Domestic short-term debt		
Avg. real interest rate	2.3%	2.3%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2033. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Malawi: Drivers of Debt Dynamics



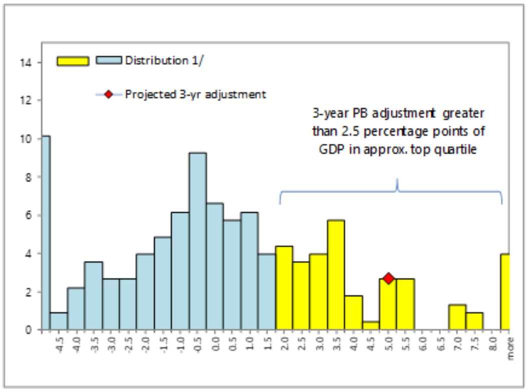
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

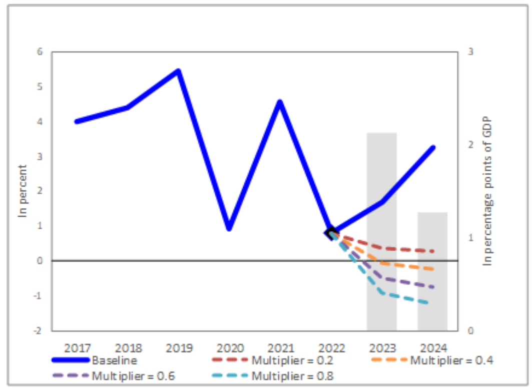
Figure 4. Malawi: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



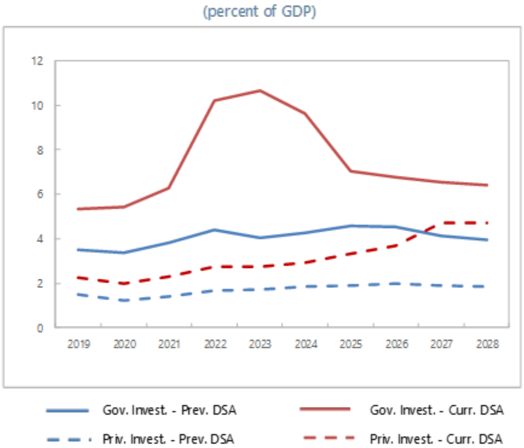
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

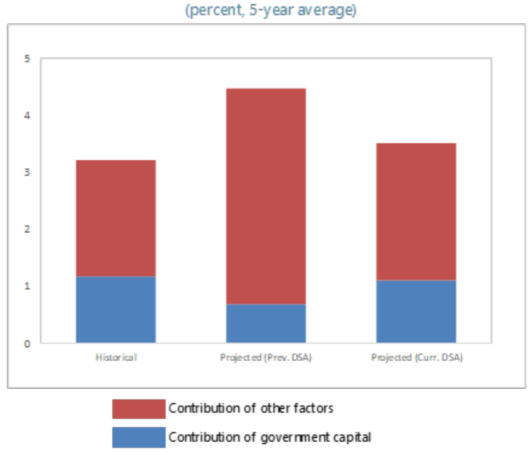


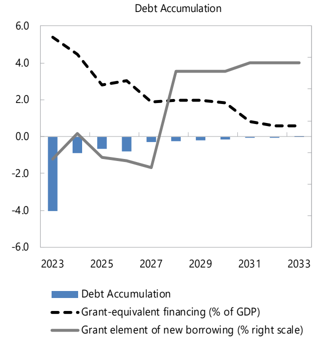
Table 1. Malawi: External Debt Sustainability Framework, Baseline Scenario, 2020–43

(Percent of GDP, Unless Otherwise Indicated)

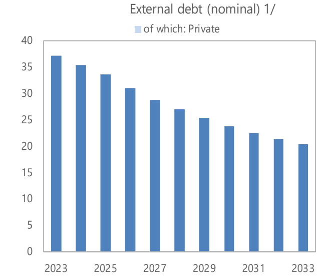
	Actual			Projections												Average 8/	
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2043	Historical	Projections
External debt (nominal) 1/	32.9	31.5	34.4	37.1	35.3	33.5	30.9	28.8	27.0	25.3	23.8	22.5	21.3	20.3	12.9	26.3	27.8
of which: public and publicly guaranteed (PPG)	32.9	31.5	34.4	37.1	35.3	33.5	30.9	28.8	27.0	25.3	23.8	22.5	21.3	20.3	12.9	26.3	27.8
Change in external debt	5.1	-1.4	2.8	2.7	-1.8	-1.8	-2.6	-2.1	-1.8	-1.7	-1.5	-1.3	-1.2	-1.0	-1.4		
Identified net debt-creating flows	11.1	11.2	2.8	5.0	6.2	6.3	4.5	4.1	3.7	3.7	3.5	2.6	2.2	2.1	-0.5	8.6	4.0
Non-interest current account deficit	13.6	13.8	2.9	4.9	7.5	7.8	6.5	6.2	5.7	5.8	5.6	4.6	4.3	4.2	1.4	10.8	5.7
Deficit in balance of goods and services	17.6	17.2	5.7	9.0	10.7	10.3	9.5	8.3	7.8	7.9	7.8	6.9	6.7	6.6	4.2	14.0	8.3
Exports	8.2	9.5	9.0	10.2	13.5	14.2	14.5	15.1	15.3	15.0	14.7	14.4	14.1	13.8	10.6		
Imports	25.8	26.7	14.6	19.3	24.2	24.5	24.0	23.4	23.1	22.8	22.4	21.3	20.8	20.4	14.9		
Net current transfers (negative = inflow)	-5.6	-4.9	-4.4	-5.7	-5.1	-4.4	-5.0	-4.2	-4.1	-4.1	-4.1	-4.2	-4.2	-4.3	-4.6	-4.8	-4.5
of which: official	-0.4	0.0	-0.6	-1.9	-0.7	-0.2	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other current account flows (negative = net inflow)	1.5	1.6	1.6	1.5	1.9	2.0	2.0	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.8	1.5	1.9
Net FDI (negative = inflow)	-0.8	-0.8	-0.3	-0.4	-0.5	-0.8	-0.9	-0.9	-1.0	-1.1	-1.2	-1.2	-1.3	-1.4	-1.4	-1.4	-1.0
Endogenous debt dynamics 2/	-1.7	-1.8	0.2	0.6	-0.8	-0.7	-1.1	-1.2	-1.0	-1.0	-0.9	-0.9	-0.8	-0.8	-0.5		
Contribution from nominal interest rate	0.2	0.3	0.3	1.2	0.7	0.6	0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1		
Contribution from real GDP growth	-0.2	-1.4	-0.3	-0.6	-1.4	-1.3	-1.4	-1.3	-1.3	-1.2	-1.1	-1.0	-1.0	-0.9	-0.6		
Contribution from price and exchange rate changes	-1.7	-0.7	0.1	...	...	...	...	...	...	...	...	...	...	...	...		
Residual 3/	-6.0	-12.6	0.1	-2.3	-8.0	-8.0	-7.1	-6.2	-5.5	-5.4	-5.0	-3.8	-3.4	-3.1	-0.8	-7.1	-5.3
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators																	
PV of PPG external debt-to-GDP ratio	...	...	23.8	19.2	21.9	20.8	19.2	18.0	16.8	15.7	14.7	13.9	13.1	12.4	7.8		
PV of PPG external debt-to-exports ratio	...	...	264.7	187.1	162.3	145.9	132.3	119.3	110.1	104.8	100.1	96.5	92.9	90.2	73.1		
PPG debt service-to-exports ratio	7.2	6.8	12.0	59.8	25.2	20.1	18.3	12.9	10.59	10.2	9.5	8.2	8.5	7.9	5.6		
PPG debt service-to-revenue ratio	4.6	4.9	7.8	44.7	23.6	18.7	17.0	11.6	9.4	8.8	8.1	6.9	7.0	6.3	19.8		
Gross external financing need (Billion of U.S. dollars)	1.6	1.8	0.5	1.4	1.1	1.1	0.9	0.9	0.8	0.8	0.8	0.7	0.7	0.7	0.2		
Key macroeconomic assumptions																	
Real GDP growth (in percent)	0.9	4.6	0.8	1.7	3.3	3.8	4.3	4.5	4.6	4.6	4.6	4.6	4.6	4.6	4.6	3.6	4.1
GDP deflator in US dollar terms (change in percent)	6.4	0.7	-0.3	1.3	-19.2	-1.4	-0.5	0.8	1.0	1.1	1.1	0.9	1.1	1.1	4.3	0.8	-1.2
Effective interest rate (percent) 4/	0.7	1.0	1.1	3.5	1.5	1.7	0.9	0.5	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.9	1.2
Growth of exports of G&S (US dollar terms, in percent)	-19.2	23.3	-5.5	17.5	10.0	7.9	6.0	9.2	6.9	3.6	3.7	3.6	3.4	3.4	3.9	-1.1	6.8
Growth of imports of G&S (US dollar terms, in percent)	0.3	9.2	-44.9	35.5	4.9	3.5	1.6	2.7	4.2	4.6	3.8	0.3	3.1	4.0	3.4	-0.5	6.2
Grant element of new public sector borrowing (in percent)	...	...	...	47.6	49.2	47.7	47.5	47.0	53.1	53.1	53.1	53.7	53.7	53.7	53.7	...	50.8
Government revenues (excluding grants, in percent of GDP)	12.8	13.2	13.8	13.7	14.4	15.3	15.7	16.7	17.1	17.2	17.3	17.3	17.2	17.2	3.0	13.3	16.3
Aid flows (in Billion of US dollars) 5/	0.4	0.4	0.7	0.7	0.5	0.3	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	5.4	4.5	2.8	3.0	1.9	2.0	1.9	1.8	0.8	0.6	0.6	0.4	...	2.3
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	81.4	78.7	71.5	77.9	71.4	78.4	79.1	78.4	64.0	53.7	53.7	53.7	...	71.6
Nominal GDP (Billion of US dollars)	12	12	13	13	11	11	11	12	13	13	14	15	16	17	30		
Nominal dollar GDP growth	7.4	5.3	0.5	3.0	-16.6	2.3	3.8	5.3	5.6	5.8	5.8	5.5	5.8	5.8	9.1	4.5	2.9
Memorandum items:																	
PV of external debt 7/	...	...	23.8	19.2	21.9	20.8	19.2	18.0	16.8	15.7	14.7	13.9	13.1	12.4	7.8		
In percent of exports	...	...	264.7	187.1	162.3	145.9	132.3	119.3	110.1	104.8	100.1	96.5	92.9	90.2	73.1		
Total external debt service-to-exports ratio	7.2	15.2	12.0	59.8	25.2	20.1	18.3	12.9	10.6	10.2	9.5	8.2	8.5	7.9	5.6		
PV of PPG external debt (in Billion of US dollars)			3.0	2.5	2.4	2.3	2.2	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.4		
(PVt-PVt-1)/GDPt-1 (in percent)				-4.0	-0.9	-0.7	-0.8	-0.3	-0.2	-0.2	-0.1	0.0	-0.1	0.0	0.1		
Non-interest current account deficit that stabilizes debt ratio	8.5	15.2	0.0	2.1	9.3	9.6	9.1	8.3	7.5	7.5	7.1	5.9	5.5	5.2	2.8		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes

Debt Accumulation



External debt (nominal) 1/



Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha (1+r)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

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

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

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

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

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

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

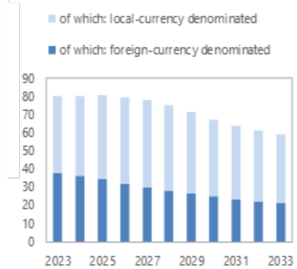
Table 2. Malawi: Public Sector Debt Sustainability Framework, Baseline Scenario, 2020–43

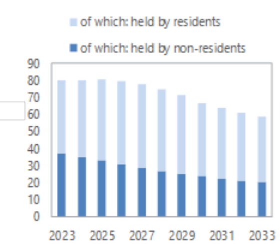
(Percent of GDP, Unless Otherwise Indicated)

	Actual			Projections								Average 6/	
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2033	2043	Historical	Projections
Public sector debt 1/	54.8	61.5	75.2	80.2	80.2	80.9	79.6	78.1	75.1	58.8	38.6	46.2	72.4
of which: external debt	32.9	31.5	34.4	37.1	35.3	33.5	30.9	28.8	27.0	20.3	12.9	26.3	27.8
Change in public sector debt	9.5	6.8	13.6	5.1	-0.1	0.7	-1.3	-1.5	-3.0	-2.4	-1.1		
Identified debt-creating flows	7.1	2.7	7.1	-7.8	-4.9	-2.5	-3.1	-3.0	-3.8	-3.2	-0.9	2.2	-4.2
Primary deficit	5.0	4.6	4.6	2.5	1.2	-0.4	-2.4	-2.2	-2.7	-2.0	-0.3	2.5	-1.5
Revenue and grants	14.5	15.0	17.3	18.0	17.7	17.1	18.0	17.9	18.5	17.2	3.0	15.5	17.8
of which: grants	1.8	1.9	3.6	4.3	3.3	1.8	2.2	1.2	1.3	0.0	0.0		
Primary (noninterest) expenditure	19.5	19.6	22.0	20.5	19.0	16.7	15.6	15.7	15.8	15.3	2.7	18.0	16.4
Automatic debt dynamics	2.1	-1.9	2.5	-10.3	-6.2	-2.1	-0.6	-0.8	-1.1	-1.2	-0.7		
Contribution from interest rate/growth differential	1.3	-3.3	-4.8	-10.3	-6.2	-2.1	-0.6	-0.8	-1.1	-1.2	-0.7		
of which: contribution from average real interest rate	1.7	-0.9	-4.3	-9.1	-3.6	0.9	2.7	2.6	2.3	1.4	1.1		
of which: contribution from real GDP growth	-0.4	-2.4	-0.5	-1.3	-2.5	-2.9	-3.3	-3.4	-3.4	-2.7	-1.7		
Contribution from real exchange rate depreciation	0.8	1.3	7.3	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	2.4	4.1	6.5	12.9	4.9	3.2	1.7	1.6	0.8	0.8	-0.2	2.5	2.7
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	66.7	68.8	68.4	69.2	68.5	67.7	65.3	51.1	33.4		
PV of public debt-to-revenue and grants ratio	...	...	385.2	382.6	386.1	403.7	381.1	378.4	353.8	296.5	1112.9		
Debt service-to-revenue and grants ratio 3/	24.9	18.7	35.9	101.1	99.2	147.1	121.1	138.0	117.5	105.5	395.3		
Gross financing need 4/	8.6	7.4	10.9	20.7	18.8	24.8	19.3	22.5	19.0	16.2	11.6		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	0.9	4.6	0.8	1.7	3.3	3.8	4.3	4.5	4.6	4.6	4.6	3.6	4.1
Average nominal interest rate on external debt (in percent)	0.7	0.6	1.1	3.8	2.0	1.8	0.9	0.5	0.8	0.8	0.8	0.9	1.3
Average real interest rate on domestic debt (in percent)	11.5	3.0	0.8	-9.3	2.1	9.0	10.6	9.4	7.9	6.5	7.2	8.3	5.4
Real exchange rate depreciation (in percent, + indicates depreciation)	4.0	5.9	25.7	...	...	...	...	...	...	...	...	12.7	...
Inflation rate (GDP deflator, in percent)	6.3	8.2	17.3	23.1	16.3	11.2	7.5	6.3	5.8	5.7	5.7	14.8	9.0
Growth of real primary spending (deflated by GDP deflator, in percent)	21.2	5.0	12.9	-5.2	-4.4	-8.4	-3.0	5.6	4.9	4.9	-74.6	6.3	0.8
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-4.5	-2.2	-9.0	-2.6	1.3	-1.1	-1.1	-0.7	0.3	0.4	0.9	-5.2	0.0
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

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

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Malawi: Sensitivity Analysis for Key Indicators of PPG External Debt, 2023–33

(Percent)

	Projections 1/										
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
PV of debt-to GDP ratio											
Baseline	19	22	21	19	18	17	16	15	14	13	12
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	19	18	17	18	19	20	22	23	26	28	**31**
B. Bound Tests											
B1. Real GDP growth	19	23	22	20	19	18	17	16	15	14	13
B2. Primary balance	19	22	21	20	19	17	16	16	15	14	13
B3. Exports	19	24	26	24	23	22	20	19	18	17	16
B4. Other flows 3/	19	23	23	21	20	19	17	16	16	15	14
B5. Depreciation	19	30	25	23	21	20	18	17	16	15	14
B6. Combination of B1-B5	19	23	21	20	19	18	16	15	15	14	13
C. Tailored Tests											
C1. Combined contingent liabilities	19	22	21	20	19	18	17	16	15	15	14
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	19	22	21	19	18	17	16	15	14	13	12
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	**187**	**162**	**146**	132	119	110	105	100	96	93	90
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	**187**	131	122	122	125	133	**145**	**160**	**179**	**200**	**223**
B. Bound Tests											
B1. Real GDP growth	**187**	**162**	**146**	132	119	110	105	100	96	93	90
B2. Primary balance	**187**	**163**	**148**	135	123	114	110	106	103	100	98
B3. Exports	**187**	**228**	**297**	**273**	**249**	**232**	**224**	**216**	**209**	**201**	**194**
B4. Other flows 3/	**187**	**170**	**159**	**145**	132	122	117	112	108	104	101
B5. Depreciation	**187**	**162**	129	116	103	95	89	84	81	78	76
B6. Combination of B1-B5	**187**	**210**	**155**	**200**	**181**	**168**	**160**	**154**	**148**	**142**	138
C. Tailored Tests											
C1. Combined contingent liabilities	**187**	**165**	**150**	137	125	117	113	109	107	104	103
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**187**	**162**	**146**	132	119	110	105	100	96	93	90
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	**59.8**	**25.2**	**20.1**	**18.3**	**12.9**	**10.6**	**10.2**	9.5	8	9	8
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	**60**	**20**	**16**	**14**	**10**	9	9	9	8	9	9
B. Bound Tests											
B1. Real GDP growth	**60**	**25**	**20**	**18**	**13**	**11**	**10**	9	8	9	8
B2. Primary balance	**60**	**25**	**20**	**18**	**13**	**11**	**10**	10	8	9	8
B3. Exports	**60**	**33**	**34**	**32**	**22**	**18**	**18**	**17**	**15**	**18**	**16**
B4. Other flows 3/	**60**	**25**	**20**	**19**	**13**	**11**	**10**	10	9	9	9
B5. Depreciation	**60**	**25**	**20**	**18**	**13**	**10**	10	9	8	7	7
B6. Combination of B1-B5	**60**	**30**	**29**	**26**	**18**	**15**	**15**	**14**	**13**	**13**	**12**
C. Tailored Tests											
C1. Combined contingent liabilities	**60**	**25**	**20**	**18**	**13**	**11**	**10**	10	8	9	8
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**60**	**25**	**20**	**18**	**13**	**11**	**10**	9	8	9	8
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	**45**	**24**	**19**	**17**	12	9	9	8	7	7	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	**45**	**19**	**15**	13	9	8	8	7	7	7	7
B. Bound Tests											
B1. Real GDP growth	**45**	**24**	**20**	**18**	12	10	9	9	7	7	7
B2. Primary balance	**45**	**24**	**19**	**17**	12	9	9	8	7	7	6
B3. Exports	**45**	**24**	**19**	**18**	12	10	9	9	8	9	8
B4. Other flows 3/	**45**	**24**	**19**	**17**	12	10	9	8	7	8	7
B5. Depreciation	**45**	**32**	**25**	**23**	**15**	13	12	11	9	8	7
B6. Combination of B1-B5	**45**	**23**	**18**	**17**	11	9	9	8	7	7	7
C. Tailored Tests											
C1. Combined contingent liabilities	**45**	**24**	**19**	**17**	12	10	9	8	7	7	6
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**45**	**24**	**19**	**17**	12	9	9	8	7	7	6
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Malawi: Sensitivity Analysis for Key Indicators of Public Debt, 2023–33

(Percent)

	Projections 1/										
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
	PV of Debt-to-GDP Ratio										
Baseline	**69**	**68**	**69**	**68**	**68**	**65**	**62**	**58**	**56**	**53**	**51**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	**69**	**70**	**70**	**68**	**65**	**61**	**56**	**52**	**48**	**45**	**42**
B. Bound Tests											
B1. Real GDP growth	**69**	**71**	**74**	**75**	**75**	**73**	**70**	**68**	**65**	**64**	**63**
B2. Primary balance	**69**	**71**	**76**	**76**	**75**	**73**	**69**	**66**	**63**	**60**	**58**
B3. Exports	**69**	**70**	**74**	**73**	**72**	**70**	**66**	**63**	**60**	**57**	**55**
B4. Other flows 3/	**69**	**70**	**71**	**70**	**70**	**67**	**64**	**60**	**57**	**55**	**53**
B5. Depreciation	**69**	**68**	**68**	**66**	**65**	**62**	**58**	**54**	**51**	**48**	**46**
B6. Combination of B1-B5	**69**	**69**	**71**	**70**	**69**	**67**	**63**	**59**	**56**	**54**	**52**
C. Tailored Tests											
C1. Combined contingent liabilities	**69**	**79**	**80**	**79**	**78**	**76**	**72**	**69**	**66**	**63**	**61**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**69**	**69**	**68**	**66**	**65**	**62**	**60**	**57**	**55**	**54**	**52**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
	PV of Debt-to-Revenue Ratio										
Baseline	383	386	404	381	378	354	333	315	316	309	297
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	383	394	410	383	367	334	309	287	276	259	242
B. Bound Tests											
B1. Real GDP growth	383	397	431	412	416	394	377	363	373	370	363
B2. Primary balance	383	402	446	422	420	394	372	354	357	350	338
B3. Exports	383	396	431	406	403	378	356	338	340	331	317
B4. Other flows 3/	383	393	415	392	389	364	343	324	326	318	305
B5. Depreciation	383	391	399	373	366	339	316	295	292	280	266
B6. Combination of B1-B5	383	389	418	392	388	361	339	319	320	313	301
C. Tailored Tests											
C1. Combined contingent liabilities	383	446	466	440	437	410	389	370	374	367	354
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	383	389	399	372	365	341	323	310	315	311	303
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	Debt Service-to-Revenue Ratio										
Baseline	101	99	147	121	138	118	121	108	112	110	106
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	101	100	145	115	124	99	96	80	77	70	62
B. Bound Tests											
B1. Real GDP growth	101	101	155	129	150	130	135	124	131	131	129
B2. Primary balance	101	99	152	134	158	136	136	124	128	126	122
B3. Exports	101	99	147	121	138	118	121	108	112	111	107
B4. Other flows 3/	101	99	147	121	138	118	121	108	112	110	106
B5. Depreciation	101	96	141	116	130	111	114	102	105	103	99
B6. Combination of B1-B5	101	97	144	124	144	124	123	111	115	114	110
C. Tailored Tests											
C1. Combined contingent liabilities	101	99	163	148	169	139	145	131	135	134	128
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	101	99	143	116	131	113	116	106	111	111	108
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Statement by Mr. Nakunyada, Executive Director for Malawi and Ms. Nainda, Senior Advisor to Executive Director
July 27, 2023

Malawi's economic outlook remains highly uncertain, on the back of a series of exogenous shocks, including the repercussions of Cyclone Freddy in March 2023, which continue to exert significant macro-fiscal pressures. While Fund support through the Food Shock Window (FSW) helped alleviate spillovers from the war in Ukraine, adverse weather shocks continue to exacerbate food insecurity. Nevertheless, the authorities remain committed to reform implementation to realize the objectives of the Staff Monitored Program with Executive Board Involvement (PMB) approved in November 2022. They view the PMB as critical to sustain the reform agenda and lay the firm foundations for deeper reforms under a new Upper Credit Tranche (UCT) arrangement. Going forward, the authorities are committed to ensure steadfast implementation of reforms under the PMB, to help build a track record of reform implementation, timely address protracted BOP challenges under a Fund-supported program, and catalyze the much-needed donor support.

Introduction

1. Our Malawian authorities appreciate the candid discussions with the country team during the mission on the first review under the Staff Monitored Program with Executive Board Involvement (PMB). They broadly share the thrust of staff's appraisal and policy recommendations.

2. The Malawian economy has suffered from the adverse effects of multiple shocks that amplified pre-existing macroeconomic vulnerabilities, interrupted the post-pandemic recovery, and setback reform implementation. More recently, devastating climate events alongside spillovers from the prolonged war in Ukraine, weakened macroeconomic fundamentals. This has culminated in mounting inflationary pressures alongside cholera outbreaks and foreign exchange shortages, with dampening effects on growth performance. Despite the manifold challenges, our authorities remain closely engaged with staff to help restore macroeconomic stability, stay the course on the reform agenda, and move swiftly towards an ECF arrangement. More generally, the authorities seek to rebalance the economy to accelerate sustainable and inclusive growth to meet their development goals as articulated in the *Malawi Vision 2063*. Against this background, the authorities have renewed their commitment to build a track record of sound macroeconomic policies under the PMB to facilitate the transition to a medium-term Fund program. They view deeper Fund engagement as critical to building resilience to shocks, while addressing protracted balance of payments challenges by unlocking complementary donor support.

Program Performance

3. Program performance in the period under review has been mixed. As at end-December 2022, four out of six continuous Quantitative Targets (QTs) and one out of three Indicative Target (ITs) were not met. Program performance was partly affected by implementation challenges due to the difficulty of reversing the course late in the fiscal year as the PMB was approved in the third quarter of the fiscal year. Nevertheless, the size of the deviation was contained, despite

the challenges compounded by climate shocks. The December 2022 QT on Net International Reserves (NIR) was missed by a small margin while the March 2023 IT was met. The targets on Reserve Bank of Malawi (RBM) financing of government were missed largely due to the issuance of a promissory note in line with the legal obligation to recapitalize the central bank. Finally, targets related to the contracting or guaranteeing of external debt have been missed as the ceiling for those targets were set from the beginning of the program while the TMU defines them as starting at the beginning of the fiscal year. Since the beginning of the program, no non-concessional external debt has been guaranteed or contracted while new concessional debt has remained within the target. That said, revenue targets were met, as well as the targets on social spending.

4. To address the slippages, the authorities are implementing strong corrective actions, including their commitment to adhere to the FY23/24 budget through quarterly allotments. The allotments are aligned with realistic revenue projections, and efforts to rebuild foreign exchange reserves, enhance coverage, timeliness, and report the repository of guarantees and underlying contracts to the IMF.

5. Three out of seven structural benchmarks (SB) were met, including the SB on quarterly allotments as well as the SB on the strategy to clear arrears. The SB on publication of audited quarterly reports will be replaced by publication of monthly reports, which is a much stronger and more timely commitment. The authorities missed four SBs owing to challenges in eliminating previously budgeted expenditures and in reducing overreliance on the central bank for foreign exchange supplies. At the same time, delays in the external debt restructuring process, and the unanticipated consequences of the kwacha devaluation in May 2022, as well as the statutorily required recapitalization of the central bank contributed to the underperformance. Meanwhile, the authorities have requested a modification of the SB on the submission of amendments to the RBM Act to Parliament by end-October 2023 (second review), as consultation with Fund staff is still ongoing.

6. To keep the program on track, the authorities have taken strong remedial actions by completing prior actions to signal their commitment to a strong reform agenda. Both prior actions related to submission of the April and May Integrated Financial Management Information Systems (IFMIS) reports to IMF staff and resuming foreign exchange auctions to facilitate price discovery in the foreign exchange market, were met. The changes in the definition of some program targets should also facilitate the authorities' monitoring of program performance. Against this background, the authorities seek Executive Directors' support in completing the first review under the PMB program, and the associated requests.

Recent Economic Developments and Outlook

7. Following a strong recovery from 0.9 percent in 2020 to 4.6 percent in 2021, real GDP growth declined to an estimated 0.8 percent in 2022. The prolonged effects of the war in Ukraine through higher fuel, fertilizer and food prices, and climate shocks continues to dampen growth performance. Reflecting the devastating effects of Cyclone Freddy on agricultural and electricity production, as well as damages to critical infrastructure, GDP growth has been downgraded from initial projections of 2.4 percent to 1.7 percent in 2023. The downward revision of growth forecasts also reflects the closure of schools and businesses, following the outbreak of cholera. However, in the medium term, expansion in output is projected to rebound

to 4.6 percent, supported by more efficient implementation of policies, commissioning of new mines, and successful execution of the export diversification strategy. Nonetheless, the growth outlook remains subject to sizable downside risks, including from a protracted war in Ukraine, adverse weather events and the protracted debt restructuring process which could delay deeper reforms.

8. Meanwhile, inflation picked up from 9.3 percent in 2021 to 20.8 percent in 2022, reflecting the depreciation of the exchange rate, as well as elevated import prices for fuel, food, and fertilizer. Nonetheless, the current account deficit narrowed significantly from 14 percent of GDP in 2021 to 3 percent of GDP in 2022, partly reflecting the compression of imports in the context of low external reserve buffers. Additionally, imports related to the cholera outbreak and humanitarian assistance in the wake of Cyclone Freddy in early 2023, exerted additional pressure on gross reserves. As a result, official reserves continue to be extremely low, covering 1.5 months of imports of goods and services by end 2022.

Fiscal Policy and Debt Management

9. Our authorities are stepping up fiscal consolidation efforts to achieve the medium-term objective of a primary balance of 0 percent of GDP and stabilize public debt. In this vein, they are implementing the Domestic Revenue Mobilization Strategy (DRMS) in a timely manner and rationalizing and prioritizing expenditures. Concurrently, they are introducing and implementing sound commitment controls and well targeted support to vulnerable households. In this regard, the authorities passed the FY2023/24 budget in line with the program macroeconomic framework and aligned spending to revenue projections to contain net domestic financing. They project a reduction of the domestic primary deficit excluding flows related to recapitalization of the RBM of about 1.3 percentage points of GDP in FY2023/24.

10. To boost fiscal revenues, the authorities have committed to decisively implement the measures announced in the DRMS. In particular, the DRMS aims to increase revenue by 5 percent of GDP over the next five years. To accelerate implementation, the authorities have incorporated the DRMS in the Malawi Revenue Authority's (MRA) strategic plan and formulated a DRMS Monitoring Committee comprising officials from the Ministry of Finance and Economic Affairs (MoFEA), MRA, Accountant General, Immigration Department, Malawi Police Service, and Registrar General in FY2022/23. The measures that are being implemented as part of the DRMS include the introduction of PAYE brackets, implementation of advance income tax, new stamp duties and introduction of VAT on selected products. To strengthen tax administration, the authorities remain on track with the implementation of the Integrated Tax Administration System (ITAS).

11. The authorities will continue to implement expenditure rationalization measures, while preserving social support to cushion the most vulnerable households. They have implemented the first phase of reforms to the fertilizer and seed subsidy program (Affordable Input Program (AIP) by allowing the National Integrated Social Safety Net Program using the Unified Beneficiary Register, to reduce duplication of access, thereby making it more efficient and better targeted. Moreover, the authorities have taken measures to prevent cost overruns in the AIP from escalating fertilizer prices and exchange rate depreciation including through increments to farmer contribution, while capping the government subsidy. The authorities also

plan to phase out the AIP in subsequent reform stages. Importantly, they have moved farmers at the lower end of the income spectrum to social protection programs and those at the higher end of the spectrum to commercial agriculture programs, supported by development partners. Following the Personnel Audit completed in 2021, the authorities are undertaking actions to manage the public wage bill by removing ghost workers, freezing new hiring to the public service, except in critical areas such as health and education, while strengthening the payroll approval process.

12. To restore debt sustainability, the authorities will continue negotiations with creditors within their debt restructuring strategy. The strategy is designed to achieve debt sustainability and close the financing gaps, with the strategy focusing on resolving current external debt challenges, including solvency and liquidity concerns. The authorities are also seeking specific and credible assurances from official bilateral creditors and have contracted a debt advisor to support a credible process for restructuring public debt and ensuring their approach delivers by creating sufficient borrowing space to accommodate a UCT quality program. Moreover, the authorities will rely more on non-debt creating flows including grant financing to avoid worsening of debt dynamics. At the same time, they are committed to strengthening debt management, monitoring, recording, and reporting.

Monetary, Exchange Rate and Financial Sector Policies

13. The RBM's monetary policy stance continues to prioritize containment of inflationary pressures. In response to rising inflation, the RBM raised the policy rate by 400 basis points to 22 percent in April 2023. To further anchor inflation expectations, the RBM stands ready to tighten monetary policy as needed, while signaling commitment to contain reserve money growth in line with its monetary program. They are also utilizing various instruments including raising required reserves, RBM's sales of government securities, and Open Market Operations (OMO) to mop up excess liquidity. At the same time, the RBM will take deliberate policy measures designed to support rebuilding of FX buffers, in a sustainable manner, and maintaining a market determined exchange rate. Specifically, the central bank will implement the agreed path towards accumulating foreign exchange reserves while limiting foreign exchange sales to the market. Moreover, the RBM will monitor short-term foreign currency drains to consistently keep track of external vulnerabilities. In parallel, the central bank is mitigating FX swap rollover risks and reducing swap costs by winding down FX swaps with non-residents, consistent with their plan to reduce the open swap position in the medium term. The RBM also resumed transparent foreign exchange auctions in June 2023 to promote price discovery and greater flexibility in the exchange rate and to foster the development of the interbank FX market (PA).

14. Malawi's banking sector remains well capitalized, with sufficient profitability although liquidity remains tight in certain instances. That said, the authorities will continue to be vigilant to financial sector risks, including through enhanced oversight. To promote financial stability, they will closely monitor the banking system's exposure to government securities and reassess loan and collateral quality needs of commercial banks.

Structural, Governance Reforms and Climate Adaptation

15. The authorities have renewed their commitment to to ensure transparency in public procurement in accordance with the Public Finance Management (PFM) Act and appropriate procedures. Currently, they are working towards reversing the recent barter trade deal to follow the proper procurement and authorization procedures. Importantly, the authorities are taking the necessary steps to avoid recurrence of such incidences and have requested Fund TA on governance diagnostics to help identify vulnerabilities in regulation, legislation, and compliance. The government is also implementing a broader governance reform agenda through the adoption of a strategy to combat corruption as set out by the President, H. E. Lazarus McCarthy Chakwera in his 2023 State of the Nation Address. To build upon recent progress and enable future PFM reforms, efforts are currently underway to enhance the oversight of state-owned enterprises (SOEs) and implementation of the new IFMIS.

16. To strengthen the RBM's autonomy, governance arrangements, and reserve management, a revised framework for the management of foreign reserves has been developed in accordance with recommendations of the 2021 Safeguards Assessment Report. In particular, the Reserve Bank Board established an Asset Liability Management Committee (ALCO). In consultation with Fund staff, they are committed to preparing and submitting the amendments to the RBM Act, as recommended in the 2021 Safeguards Assessment, to public consultation first then to the Parliament by end-October 2023.

17. Malawi remains susceptible to natural disasters, with the frequency and intensity of adverse weather events having increased in recent years. The recurring droughts, flooding and late-onset and erratic rainfall have disrupted food systems, undermined food security, and destroyed key infrastructure. Given the reliance on rain-fed subsistence farming of the country, the authorities recognize that climate adaptation finance is needed to develop resilient infrastructure and climate-smart agricultural practices. In this regard, they continue to work closely with key partners, including by developing a more efficient agricultural subsidy program to target the most vulnerable households. While agriculture remains fundamental to the economy, the authorities also aim to reduce dependance on agriculture through the implementation of the *National Export Strategy*.

Conclusion

18. Despite the multiple shocks and their negative repercussions on the economy, the authorities remain committed to reforms under the PMB. As such, they are undertaking strong corrective actions to strengthen program performance. In this vein, they re-affirm their commitment to implement the agreed macroeconomic adjustment and reforms to build the policy track record needed to support their future request for an Extended Credit Facility (ECF) arrangement. They look forward to continued engagement with the IMF as well as the Executive Board's favorable consideration to proceed with their endeavors to stabilize macroeconomic conditions and place the economy onto a sustainable and inclusive development path.