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Republic of Madagascar: Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Requests for Waiver of Nonobservance of Performance Criteria and Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director of the Republic of Madagascar

In the context of the fifth review under the three-year arrangement under the Poverty Reduction and Growth Facility, requests for a waiver of nonobservance of performance criteria and modification of performance criteria with the Republic of Madagascar, the following documents have been released and are included in this package:

- the staff paper for the fifth review under the three-year arrangement under the Poverty Reduction and Growth Facility, requests for waiver of nonobservance of performance criteria and modification of performance criteria, prepared by a staff team of the IMF, following discussions that ended on September 10, 2004, with the officials of the Republic of Madagascar on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 30, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the views of the Executive Board as expressed during its October 18, 2004 discussion of the staff report that completed the request and review.

- a statement by the Executive Director for Republic of Madagascar.

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

Heavily Indebted Poor Countries Initiative—Completion Point Document
Joint Staff Assessment of the Poverty Reduction Strategy Paper Progress Report
Letter of Intent sent to the IMF by the authorities of the Republic of Madagascar*
Poverty Reduction Strategy Paper Progress Report
Technical Memorandum of Understanding*
*May also be included in Staff Report

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

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Nonobservance of Performance Criteria, and Modification of Performance Criteria

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Departments)

Approved by Thomas Krueger and Mark Plant

September 30, 2004

- Discussions for the fifth review under the PRGF arrangement took place during June 21-July 5 and September 3-10, 2004, in Antananarivo. The principal Malagasy representatives included Mr. Radavidson, the Minister of Economy, Finance, and Budget, and Mr. Ravelojaona, Governor of the Central Bank of Madagascar (BCM). The mission was received by the President, Mr. Ravalomanana. The mission also met with the President of the Senate, representatives of trade unions, and the business and donor communities.

- The staff team comprised Mr. Fayolle (head), Mr. Nassar, Ms. Allain (all AFR), Ms. Khemani (PDR), Mr. Jahjah (Resident Representative), and Mrs. Ng Choy Hing (Assistant-AFR). Mr. Ismael (Senior Advisor to the Executive Director for Madagascar) attended the June/July discussions. The mission worked closely with the World Bank staff based in Madagascar.

- This report covers the fifth PRGF review; it will be accompanied by a Joint Staff Assessment of the Poverty Reduction Strategy Paper annual progress report and the HIPC completion point document.

- Four quantitative performance criteria for end-March have been missed (Appendix II, Tables 1 and 2), but deviations were generally small—with the notable exception of the floor on net foreign assets—and were largely related to the impact of two cyclones. At end-June, two out of ten quantitative indicative targets were missed, but measures have been taken to bring tax revenue back on track in July, and the level of international reserves has significantly increased since July. Progress was made in public enterprise reform, although with some delays. The privatization of the cotton company, a structural performance criterion at end-March, is expected by end-September 2004, and the performance criterion on the selection of the private company to manage the sugar company at end-June was met.

Contents Page

Boxes

Figures

Text Tables

Tables

Appendices

Executive Summary

Recent developments and performance under the program in the first half of 2004

- Macroeconomic performance in the first half of 2004 has been impacted by two major cyclones, but also by policy slippages that contributed to a depreciation of the currency by about 50 percent against the euro and two major cyclones. Real GDP growth has been revised downward slightly and inflation has begun to rise sharply.

- Madagascar's performance under the program was broadly satisfactory, taking into account the impact of the exogenous shocks and corrective actions taken by the authorities. Moreover, efforts to bring tax revenue and net foreign assets—the two indicative targets missed at end-June—back on track over the summer were successful. Progress was also made in structural reform, although with some delays. The privatization of the cotton company was delayed, but the company that will manage the sugar company was selected in June, and petroleum prices were fully liberalized in July.

Economic policies in the period ahead

- Given the inflationary pressures, weakening external trade position, and low international reserves, the key objectives of the program are to safeguard macroeconomic stability. This would require limiting the second-round effects of the temporary supply-side and exchange rate shocks, reducing volatility on the foreign exchange market, and securing a gradual build-up in official reserves.

- To achieve these objectives, the authorities have adopted a broad-based policy package, including (i) fiscal measures, in order to broadly maintain the domestic fiscal balance target for 2004; (ii) monetary tightening, with a view to containing inflationary pressures; and (iii) acceleration of the pace of structural reforms.

- On fiscal policy, the authorities are determined to pursue the implementation of corrective actions—especially at customs—to ensure that the revenue target for 2004, set at 11.2 percent of GDP, can be met. For 2005, the domestic balance is to be reduced by 1 percent of GDP relative to the 2004 outcome.

- The authorities are committed to improving the effectiveness of monetary policy as an anti-inflationary instrument. To this end, they intend in particular to continue to strengthen liquidity management.

- Staff supports the authorities' request for completion of the fifth review and waivers of nonobservance of four quantitative and one structural performance criteria.

I. Introduction

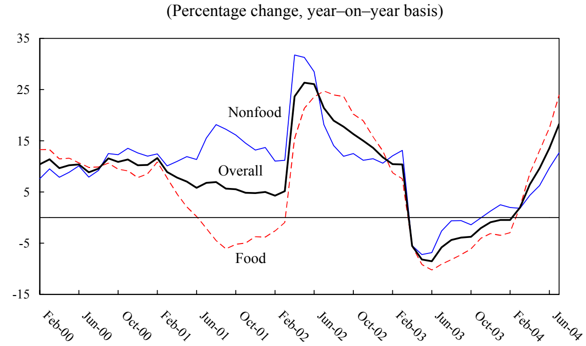
1. On March 17, 2004, the Executive Board completed the fourth review and extended the PRGF arrangement until March 1, 2005. It also approved the authorities' request for an augmentation of access from the equivalent of SDR 79.43 million to SDR 91.65 million (75 percent of quota; IMF Country Report No. 04/91) with the additional access constituting immediate balance of payments support linked to the expected impact of Cyclone Gafilo, which hit Madagascar in early March 2004. Executive Directors welcomed Madagascar's strong growth performance in 2003, but expressed concern that fiscal slippages had emerged in the second half of the year and that progress in implementing structural reforms had been slower than expected. They called on the authorities to implement vigorously the fiscal measures outlined in the 2004 budget, and ensure that all social expenditures are carried out consistent with the HIPC Initiative's targets.

2. In the attached letter of intent (LOI) dated September 29, 2004 (Appendix II), the Minister of Economy, Finance, and Budget and the Governor of the BCM review progress under the 2004 program, outline the government's economic and reform program for 2004-05, and request waivers for the performance criteria missed at end-March 2004. The schedule of future disbursements and program reviews is presented in Table 1.

II. Recent Developments and Performance Under the Program

3. **Two developments were critical in shaping the macroeconomic performance in 2004—cyclones and a sharp depreciation of the exchange rate**. After declining in 2003, consumer price inflation (CPI) has begun to rise sharply in 2004, reaching 17.7 percent (on a year-on-year basis) in July, mainly on account of soaring petroleum and rice prices, reflecting increases in international prices and a partial pass through of the depreciation of the exchange rate (Figure 1 and Text Box 1 below). Real GDP growth in 2004 has been revised downward by 0.7 percentage point from the initial program objective to 5.3 percent, still consistent with PRSP objectives. Despite the impact of two major cyclones that hit Madagascar in early 2004 and a sharp increase in the cost of inputs, growth was supported by increased demand for public investment (mainly infrastructure) and strong activities in the tourism sector and export processing zones (EPZs).

Figure 1. Consumer Price Index,
February 00–July 04
(Percentage change, year–on–year basis)



Source: Malagasy authorities.

Text Box 1. Rice Price Developments in 2004

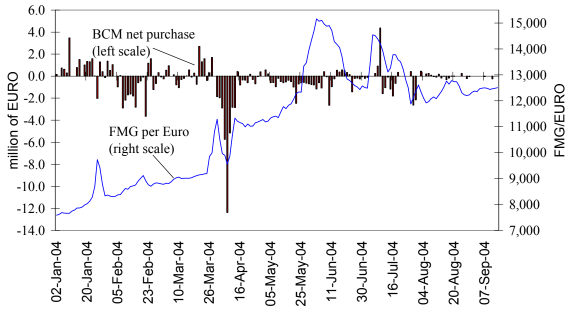
Rice is the most important staple food in Madagascar and its price has risen sharply in 2004. Rice accounts for about 15 percent of the CPI basket and its price increased by 45 percent (year-on-year) in July (up from –6 percent in December 2003). This reflected foremost higher international prices and the sharp depreciation of the Malagasy franc. Domestic supply conditions remained broadly in line with those in 2003, notwithstanding the effects of two cyclones that hit the country in January and March. As a result, Madagascar is expected to import about 200,000 tons of rice in 2004, broadly similar to 2003.

To limit the potential impact of the rice price increases on the poor, the government appealed to rice growing countries to facilitate the import of cheap rice by Malagasy importers. As a result, private importers secured a deal with Thailand to import 100,000 tons. Similar agreements are expected to be reached with other countries. Thailand and Japan also committed more than 10,000 tons of rice in the form of grants. Importers and distributors in Madagascar are committed to pre-financing the imports and reducing their margins. With the imminent arrival of these imports, prices of domestic rice started to drop in September, which should help rein in overall inflation.

4. **The balance of payments weakened and the Malagasy franc (FMG) depreciated sharply in the first five months of 2004, with supply-side shocks, unfavorable international prices developments, as well as some policy slippages—tax and tariff exemptions[1]—contributing to the depreciation**. The FMG depreciated by about 50 percent against the euro (Figure 2 below), owing notably to (i) strong imports as a result of an acceleration of private imports in response to the tax and tariff exemptions, higher petroleum prices, and increased government capital expenditures; and (ii) weak exports, owing to the impact of the cyclones on the vanilla and shellfish sectors. Exchange rate volatility was exacerbated by erratic liquidity management in domestic money markets and structural weaknesses in the foreign exchange market (see below). The real exchange rate depreciated sharply over the same period (Figure 3 below). The performance criterion on the floor of net foreign assets at end-March was missed, as the central bank was unable to accumulate sufficient foreign exchange in the context of the sharp depreciation.

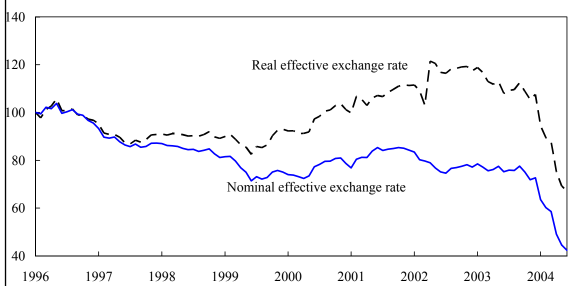
[1] In September 2003, the government granted tax and tariff exemptions for imports of capital goods and selected other commodities, including luxury goods.

Figure 2. Net Purchase of Foreign Exchange by the Central Bank, January 2 - September 14, 2004 (in Euros)



Source: Malagasy authorities.

Figure 3. Real and Nominal Exchange Rates, January 1996–June 2004
(Monthly average, 1996=100)



Source: IMF: *International Financial Statistics*.

Text Table 1: Credit to Private Sector, 2003-04
(In billions of Malagasy francs, unless otherwise indicated)

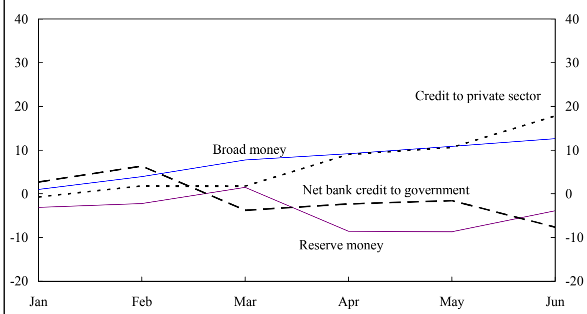
	2003			2004			2004
	Jun.	Jul.	Dec.	Jun.	July	Aug. Prel.	July Percent change since December 03
Total loans	2,492.5	2,538.0	3,005.7	3,646.4	3,749.0	3,482.3	24.7
Short-term loans	1,820.8	1,838.7	2,185.9	2,535.0	2,568.7	2,325.0	17.5
Of which: overdrafts	1,013.2	1,054.4	1,071.5	1,479.7	1,528.7	...	42.7
Of which: oil companies	8.0	9.9	64.0	215.4	248.6	...	288.4
Medium-term loans	484.1	503.1	618.5	836.1	879.8	879.1	42.2
Long-term loans	195.5	196.3	201.4	275.1	280.7	278.2	39.4
Total loans denominated in foreign exchange	108.4	123.1	177.4	364.2	324.8	...	83.1
(in millions of Euros)	15.5	17.7	23.3	29.0	26.2	...	12.7
Total loans excluding the effect of exchange rate depreciations in 2004	2,492.5	2,538.0	3,005.7	3,502.9	3,624.1	...	20.6
Amount guaranteed 1/	112.4	149.9	92.9	254.0	396.3	...	326.6
Memorandum items:							
Overdrafts/total credit (in percent)	40.6	41.5	35.6	40.6	40.8	...	
Amounts guaranteed/total credit (in percent)	4.5	5.9	3.1	7.0	10.6	...	
Credit to oil companies/overdrafts (in percent)	0.8	0.9	6.0	14.6	16.3	...	
Exchange rate FMG per 1 Euro (end of period)	6,967.0	6,957.0	7,622.0	12,576.0	12,385.0	...	

Source: Banking and Financial Supervision Commission (CSBF), Central Bank of Madagascar.
1/ These are guarantees provided for local subsidiary banks by their headquarters abroad. It excludes one local bank whose parent bank (abroad) guarantees all loans exceeding the single borrower exposure limit.

5. **The exchange rate stabilized over the summer and the level of foreign reserves increased, following fiscal and monetary policy adjustment measures**. The foreign exchange market appears to have reached a turning point in early June 2004, as the government announced important adjustment measures (see below). Furthermore, the foreign exchange auction system was replaced by an electronic trading system in July 2004 (a structural benchmark under the program for end-March). Although implementation is at an early stage, the new system has so far led to lower exchange rate volatility.

6. **The foreign exchange market developments also had a significant impact on monetary aggregates during the first half of 2004** (Figure 4). Broad money (M3, including foreign currency deposits) grew by 12.6 percent, reflecting the effect of the depreciation on the domestic currency value of foreign exchange deposits. Reserve money declined by 3.9 percent, owing to foreign exchange interventions by the central bank (net sales amounted to € 58 million). Credit to the private sector increased by over 17 percent at end-June, 2004, mainly due to overdrafts granted to oil companies (Text Table 1 above and Table 6).

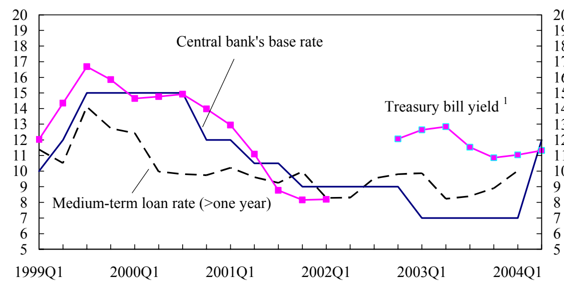
Figure 4. Money and Credit Developments, January - June 2004
(Percentage change since end-December 2003)



Source: Malagasy authorities.

7. **Inconsistent implementation of monetary policy and inadequate coordination between the Ministry of Finance and the BCM sometime led to erratic liquidity management, but the situation has recently improved**. On the one hand, the BCM raised its base rate on two occasions in April and early June, increased reserve requirements on demand deposits, and reduced banks' maximum net open foreign exchange positions. On the other hand, it accommodated banks' requests for additional liquidity by purchasing treasury bills from them. Liquidity was also expanded following the decision by the Treasury to retire maturing treasury bills by drawing on its deposits at the central bank. Given the inflationary environment, the BCM discontinued the practice of outright purchase of treasury bills from banks in early July and further tightened monetary policy by (i) widening the reserve requirement base; (ii) conducting a reverse auction in August for the first time since 2002 and another one in mid-September; and (iii) increasing the base rate for a third time on September 16 (LOI, ¶9-11). These measures seem to have had an impact, as evidenced by the drop in excess liquidity in the banking system and an increase in interest rates (Figure 5).

Figure 5. Weighted-Average Interest Rates, 1999:Q1–2004:Q2
(In percent)



Source: Malagasy authorities.
[1]No treasury bill auctions were conducted during March-September 2002.

8. **The overall health of the banking sector has improved in recent years** (Text Table 2 below), owing in large part to the arrival and dominance of foreign banks and strengthened banking supervision. The exposure of some banks to a few "niche" borrowers increased substantially in recent months (LOI, ¶12). Nevertheless, regulatory capital to risk-weighted assets of the banking system remains fairly high. Banking supervision needs to be further strengthened, given that nonperforming loans (NPL) for the banking system as a whole remain high, even if they continued to decline, as medium-sized and large enterprises recovered from the 2002 economic crisis.

Text Table 2. Bank Soundness Indicators, December 1998 to June 2004

	1998	1999	2000	2001	2002	2003	2004 Jun. Prov.
	(Ratio; in percent)						
Capital adequacy							
Regulatory capital to risk-weighted assets							
Lowest ratio	8.6	9.7	10.1	12.0	11.4	10.7	9.4
Highest ratio	30.5	28.7	32.2	34.1	38.7	38.5	49.1
Asset quality							
Nonperforming loans to total gross loans	21.1	8.4	8.4	10.3	19.5	16.5	16.3
Earnings and profitability							
Return on assets	3.2	4.3	4.0	2.8	1.1	3.2	5.2
Return on equity	91.0	53.0	47.0	39.0	16.0	45.6	33.4
Noninterest expenses to gross income	46.5	42.9	45.4	48.9	52.2	46.9	42.4
Personnel expenses to noninterest expenses	44.6	36.7	38.4	35.3	38.3	38.8	36.1
Liquidity							
Liquid assets to total assets	35.9	37.0	36.9	44.2	52.1	50.5	49.4
Liquid assets to short-term liabilities	61.9	61.2	62.2	70.0	77.8	74.5	74.5
	(In billions of Malagasy francs)						
Memorandum items:							
Total assets	4,222.0	4,931.0	5,668.0	6,723.0	6,965.2	7,635.9	7,635.9
Total profits before tax	137.2	214	226.5	186.6	79.7	242.4	199.5

Source: Banking and Financial Supervision Commission (CSBF), Central Bank of Madagascar (BCM).

9. **Revenue performance during the first half of the year remained slightly below program objectives, mainly reflecting the impact of the cyclones and the tax exemptions granted in 2003, but have improved recently**. Tax revenues were 0.03 percent of GDP below the performance criterion at end-March and about 0.1 of GDP below the program indicative target at end-June. These revenue shortfalls stem largely from the impact of the cyclones, estimated at about 0.1 percent of GDP, during the first six months of the year. At the same time, the expected increase in customs revenue following the sharp depreciation of the currency did not materialize, as revenue performance at customs continued to be affected by the tax exemptions and persisting weaknesses in customs administration. In view of these developments, the authorities implemented corrective actions in July 2004, notably by intensifying the fight against fraud at customs, tightening eligibility to customs duties advances, and rescinding the tax exemptions on non-capital goods (LOI, ¶16-17). Following implementation of these measures, fiscal revenue was brought back on track.

10. **The widening of the domestic balance led to higher than anticipated domestic financing at end-March but performance was back on track at end-June, following the reining in of noninterest current expenditures**. The deviation from the end-March performance criterion on domestic financing of the government was 0.2 percent of GDP, and reflected both the shortfall in revenue and the acceleration of the execution rate of domestically-financed investment, as the authorities strove to repair the cyclone-related damages to public infrastructure, particularly in priority sectors (LOI, ¶6). The indicative target on domestic financing at end-June was met, reflecting efforts made during the second quarter to contain noninterest current expenditures.

11. **Implementation of the structural reform program was mixed**. The completion of the bidding process for the purchase of the cotton company, HASYMA (a structural performance criterion for end-March 2004) was delayed (LOI, ¶6). On the positive side, the end-June performance criterion on the completion of the bidding process for the selection of the company that will manage the sugar company, SIRAMA, has been met, and petroleum prices were fully liberalized in July 2004.

12. **A number of measures were introduced in 2004 to enhance governance and improve the efficiency of the public sector** (LOI, ¶14). Progress has been made in implementing the government's priority action plan, which aims at operationalizing the public finance reform program, including an overhaul of the procurement system. The joint private-public sector committee overseeing the efforts toward combating fraud and corruption in the tax and customs department continues to meet on regular basis.

III. Policy Discussions

13. **Given the inflationary pressures, weakening external trade position, and low international reserves, the policy discussions focused on measures to safeguard macroeconomic stability**. This would require limiting the second-round effects (for example, wage increases, or price increases in services) of the temporary supply-side and exchange rate shocks, reducing volatility on the inter-bank foreign exchange market, and securing a gradual build-up in official reserves. To achieve these objectives, the authorities have adopted a broad-based policy package, including (i) fiscal measures, in order to broadly maintain the domestic fiscal balance target for 2004; (ii) monetary tightening, with a view to containing inflationary pressures; and (iii) acceleration of the pace of structural reforms, especially in the areas of fiscal management, public enterprise reform, and credit and money market development. The program for the remainder of 2004 and 2005 sets out the main policies in these areas.

A. The Macroeconomic Framework for 2004-05

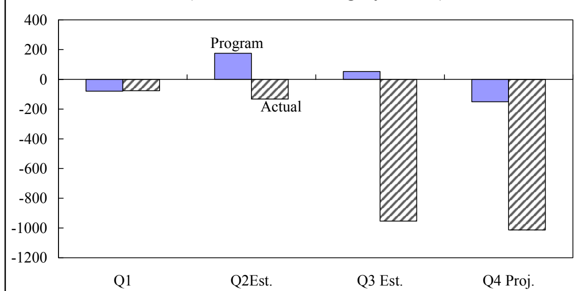
14. The revised macroeconomic program seeks to (i) achieve real GDP growth of 5.3 percent in 2004 and 7 percent in 2005; (ii) contain inflation to about 15 percent (on a year-on-year basis) at end-December 2004, but close to the original target of 5 percent by the end of 2005; and (iii) secure a gradual build-up in official reserves to three months of imports by end 2004 and a further increase in the coming years.

15. **The authorities noted that these objectives were subject to considerable risks, even if policies were fully implemented as outlined below**. As demonstrated in 2004, the Malagasy economy remains vulnerable to weather and commodity price shocks. Moreover, the government would be under pressure to increase further civil service wages in 2005 if the minimum wage in the private sector, already increased by 16 percent in March 2004, were to be further increased in the fall.

B. Fiscal Policy

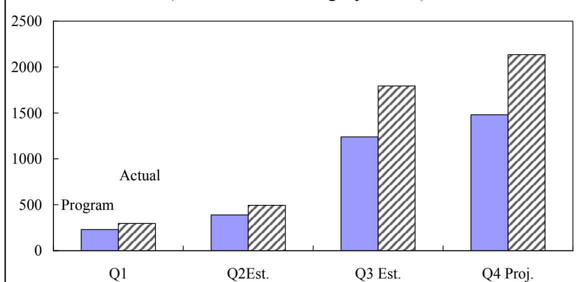
16. **The authorities remain committed to implementing a fiscal policy aimed at limiting the second round effects of rising inflation**. They are determined to pursue the implementation of corrective actions to ensure that the revenue target for 2004, set at 11.2 percent of GDP, can be met. In particular, as noted above, customs revenue collection is expected to strongly increase over the second half of the year. Noninterest current expenditures will also be reduced by 0.6 percent of GDP, as the authorities have cut non-wage current expenditures in non-priority sectors by 10 percent, and will maintain a prudent wage policy during the remainder of the year in order to avoid a wage-inflation spiral (LOI, ¶16).[2] However, the domestic balance is expected to worsen slightly, mainly reflecting the increase in interest rate charges and in domestically financed capital expenditures, as the execution rate of investment expenditures accelerated. Combined with the increase in the domestic value of external support, this would allow for an increase in government repayment of its domestic debt of 1 percent of GDP, compared to the program (Figures 6 and 7).

Figure 6. Change in Net Bank Credit to Government, 2004
Cumulative since end-December 2003
(In billions of Malagasy francs)



Source: Malagasy authorities.

Figure 7. Total External Budgetary Support (Grants and Loans),
Cumulative Quarterly Data for 2004
(In billions of Malagasy francs)



Source: Malagasy authorities.

17. **The authorities explained to staff that some reallocation of non priority spending within the revised budgetary envelope, amounting to about 0.25 percent of GDP, will be necessary**. Initial allocations for certain line items (notably military wages and payments to the pre-shipment inspection company) proved insufficient to cover actual expenditures for the year as a whole. In order to avoid the recurrence of this problem in 2005, the authorities agreed to improve the budget preparation process with a view to minimizing mid-year changes to the budget, and to strengthen budget execution, notably by ensuring that military

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[2] Nominal wages will increase by 6 percent in 2004, following a large increase in 2003. This will imply a decline in the wage bill-to-GDP ratio to 4.9 percent in 2004, only partially reversing the sharp increase observed in 2003 (to 5.6 percent, from 4.6 percent in 2002).

wage bill expenditures follow the same budgetary procedures as all other wage-related spending (LOI, ¶18).[3]

18. **Understandings were reached on the main aggregates of the 2005 fiscal framework** (LOI, ¶20). The main objectives of the 2005 budget will be to improve the domestic balance by 1 percent of GDP relative to the 2004 outcome. This reflects the strengthening of public finances following the full implementation of the revenue enhancing measures as well as the phasing-out of cyclone-related expenditures. The 2005 fiscal framework foresees, inter alia, an increase in Madagascar's comparatively low revenue-to-GDP ratio to 11.8 percent, from 11.2 percent in 2004 (LOI, ¶20). The continuation of a prudent wage policy will be crucial to contain inflation, while allowing for significant recruitments in some key priority sectors. Total wage bill expenditure will slightly increase to 5 percent of GDP in 2005. The framework also allows for a robust increase in non-wage priority sector spending, which will be derived for the first time from the program budgets prepared by the priority ministries, with a view to improving the alignment between the budget and PSRP objectives, and an increase in capital expenditures.

C. Monetary Policy and Financial Sector Reforms

19. **The authorities developed their monetary program with a view to achieving a monetary-fiscal policy mix aimed at reining in inflation**. Accordingly, broad money (M3) is programmed to increase by 12.6 percent during the year. Given the targeted increase in net official external reserves and the government's plans to avoid recourse to bank financing, the monetary program allows credit to the private sector to grow by about 22 percent, similar to 2003. The pick-up in crop financing during the second half of the year should limit the decrease in base money to 1.4 percent by end-December, up from a 3.9 percent drop at end-June.

20. **The main challenges in the area of monetary policy are to improve its effectiveness as an anti-inflationary instrument**. Until recently, the only effective tools available to the BCM to manage liquidity were the sale of foreign exchange and the use of reserve requirements.[4] The authorities intend to continue to strengthen liquidity management and avoid inconsistency in the use of monetary policy instruments, including through more frequent use of reverse auctions and the development of the money market (LOI, ¶23). The authorities stressed that building capacity will be crucial to achieve these objectives.

21. **Progress has been made in implementing the main recommendations of the safeguards assessment report** (LOI, ¶24). The audit of reserve money management and

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[3] Currently, the Ministry of Finance does not have any oversight over military wages, with the Minister of Defense being solely responsible for the execution of these expenditures.

[4] For the purpose of the program, the technical memorandum of understanding has been modified in order to adjust for changes in the reserve requirement ratio.

foreign exchange activities is being implemented with assistance of the Fund's Monetary and Financial Systems Department (MFD). The BCM's new accounting framework is to be approved by its Executive Board in October 2004, and the new accounting framework for banking institutions to be submitted to the High Court of Accounts for approval shortly thereafter.

D. External Sector Issues

22. **The outlook for the balance of payments for 2004 calls for a substantive widening of the current account deficit (excluding official transfers)**. The trade balance will deteriorate substantially in 2004, compared with the program, reflecting higher imports driven by tax exemptions as well as the immediate effect of the negative terms of trade shock as the price of vanilla fell and that of oil increased. Growth in the EPZs and tourism sector, a slowdown in imports, and the increase in external assistance are expected to increase international reserves to 3 months of imports by year-end. Partly reflecting the effects of the large depreciation, the current account is expected to improve in 2005, but international commodity prices present important risks.

23. **The authorities are committed to implementing prudent macroeconomic policies, with a view to preserving recent gains in competitiveness while maintaining a flexible exchange rate policy**. The authorities and staff agreed that the current level of price competitiveness was broadly adequate and that maintaining competitiveness would be essential, especially given that a large share of exports is in the textile sector, which can relocate quickly depending on competitive conditions. The authorities are also aware that structural reforms and strategies to diversify exports are critical. The extension of AGOA to 2015, and particularly AGOA III for four years, will allow Madagascar some time to deal with the upcoming shocks resulting from the expiry of the WTO Agreement on Textiles and Clothing in January 2005. The authorities are also exploring ways to reverse the recent decline in agro-based exports. Moreover, Madagascar has been selected among countries that could benefit from the newly created US Millennium Challenge Corporation (MCC), which may help attracting more foreign direct investments.

24. **The central bank will continue to monitor developments on the new interbank foreign exchange market**. Staff agreed that the new system represented a significant change for the central bank, which needed to ensure it received all the information required to carry out its foreign exchange policy. The central bank will also prepare guidelines for its interventions on the foreign exchange market by end-2004.

E. Structural and Governance Issues

25. **The authorities intend to intensify their efforts to deepen structural reforms and improve governance further**. In particular, the completion of the bidding process for the privatization of the cotton company, HASYMA, is expected by end-September 2004 (this constitutes a prior action under the program) and the utility company, JIRAMA, will be placed under private management contract by end-October. Progress is also expected in

modernizing the financial sector and rehabilitating the port infrastructure and rail network. Moreover, new anti-corruption legislation has been promulgated on September 9, 2004, allowing for the creation and staffing of an independent anti-corruption bureau. With governance issues viewed as hindering more dynamic economic development, the establishment of the bureau, expected in September 2004, is a prior action under the program.

F. PRSP and Medium-Term Framework

26. **The sources of growth in the medium term are similar under the PRSP and the PRGF-supported program**.[5] Growth during 2005-09 is expected to be broad-based and average about 6 percent per year. Boosted by trade liberalization and investment stimuli, both private and public investment are expected to increase relative to GDP (Table 9), assuming foreign direct investment and donor assistance materialize as envisaged.

27. **The authorities' strategy for achieving sustained economic growth and poverty reduction rests on the pursuit of prudent macroeconomic policies and reforms aimed at removing supply-side constraints**. In this regard, they intend to enhance transparency and efficiency in public resource management, reorient their investment effort toward the priority sectors to strengthen the impact on poverty reduction, and increase the role of the private sector in the economy. They also plan to accelerate the pace of structural reforms, especially in the areas of fiscal management, public enterprise reform, credit and money market development, and the legal framework affecting the business environment.

28. **The budgetary framework for the medium term aims at reducing the overall deficit (on a commitment basis and excluding grants) to about 7 percent of GDP in 2009 from 9.3 percent of GDP in 2003**. Staff agreed that this should be consistent with growth, inflation, and balance of payments objectives over the medium term. Achieving this target would require additional revenue efforts, including steps to remove remaining tax exemptions and tax expenditures.

29. **The value of exports and imports are to grow by an annual average rate of 12 and 9 percent respectively over the medium term, spurred in part by trade liberalization and regional integration** (Table 2). Export growth is to be fueled by diversification, both within and outside the EPZs, the improved quality of cotton, and a rebound in the volume of vanilla exports as measures are implemented to curb theft. Import growth is also to be strong despite an assumed decline in rice imports, with an expected strong growth and investment. This evolution will be supported by the implementation of the

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[5] The first progress report of the PRSP was submitted to the Fund and the World Bank in mid-July, 2004. The report and the joint staff assessment (www.imf.org) are to be discussed jointly with this staff report.

Integrated Framework (IF) program and the recommendations of the Diagnosis Trade Integration Study (DTIS).[6]

30. **All but two of the conditions pertaining to the HIPC completion point structural triggers have been met, but progress toward achieving the Millennium Development Goals (MDGs) has been mixed** (Table 10). A recent debt sustainability analysis (DSA), conducted by the staffs of the Bank and the Fund together with the Malagasy authorities, finds that after the provision of enhanced HIPC assistance and additional bilateral assistance, the NPV of debt-to-export ratio will come down below HIPC thresholds and, with appropriate policies implemented, the ratio will continue to trend down.[7] An increase in resources, better policies, and improved effectiveness of institutions could reduce the likelihood that some of the MDG targets would not be met. In particular, reaching the target to halve the proportion of people suffering hunger requires a comprehensive strategy to boost growth and productivity in the agricultural sector.

IV. PROGRAM MONITORING

31. **Implementation of the program will be monitored through quantitative and structural performance criteria and benchmarks** (see LOI, Tables 1 and 3). The original quantitative performance criteria and benchmarks for end-September have been revised to reflect the depreciation of the exchange rate (the program exchange rate has been changed from FMG 8,904.7 per SDR to FMG 13,739.3 per SDR), the sale of foreign exchange by the central bank during the first half of 2004 (which impacts significantly the reserve money target and the floor on net foreign assets), the difference between actual and projected end-December 2003 data, and measures taken to increase tax revenue in the second half of 2004. These changes reflect the somewhat tighter monetary stance the authorities have adopted in response to inflationary pressures in early 2004. The structural measures focus on securing the installation of the most recent ASYCUDA software at customs and preparing guidelines for the central bank’s interventions on the foreign exchange market. These measures and targets are complemented by structural measures monitored by the World Bank under the PRSC (Appendix IV). A revised technical memorandum of understanding (Appendix II, Attachment IV) updates definitions and reporting requirements. The sixth and last review of the three-year arrangement is expected to be completed in February 2005.

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[6] The Integrated Framework was established at a high-level WTO Meeting in October 1997 to facilitate coordination of trade-related technical assistance and promote an integrated approach for enhancing the trade opportunities of the least developed countries. The World Bank is the lead agency on the DTIS. Further details on the authorities’ trade strategy are described in the joint staff assessment of the first progress report of implementation of the PRSP (¶19).

[7] See the Completion Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative.

Text Box 2. Structural Conditionality

Coverage of structural conditionality in the program for 2004
Structural performance criteria and benchmarks cover efficiency in revenue administration and financial management, including (i) no granting of tax and tariff exemptions beyond those specified in the 2004 budget law; (ii) testing the newly installed ASYCUDA system at customs. In additional, preparation of guidelines for the central bank's intervention in the interbank foreign exchange market and publication of the BCM's audited financial statements constitute benchmarks. Furthermore, prior actions for Board consideration of the document include: (i) hiring of staff and beginning of operations of the independent anticorruption bureau; and (ii) completion of the bidding process for the privatization of the cotton company.

Status of structural conditionality in earlier years
Structural conditionality in earlier programs covered efficiency and transparency in the public sector, including completion of the bidding process for the purchase of the cotton company; completion of the bidding process for the selection of the company that will manage the sugar company; publication of the central bank's 2001, 2002, and subsequent financial statements and attendant audit opinions; and replacement of the current system of foreign exchange auctions with an interbank foreign exchange trading system.

Structural areas covered by World Bank conditionality
The World Bank is providing assistance to implement several structural reforms relevant to the Fund-supported program, including (i) assistance in strengthening the management of the electricity and water company; (ii) reforms and capacity building at the land registry; (iii) the strengthening of judicial procedures, and reform of the business law; (iv) budget, treasury, and tax administration reforms; and (v) strengthening of the monitoring of social expenditures. World Bank assistance has gradually started to shift from investments to programmatic lending, requiring several policy actions fundamental to their success. A technical assistance project on governance to support the necessary structural reforms is ongoing.

Structural areas covered by the African Development Bank and the European Union
The African Development Bank is implementing a new structural adjustment credit aimed at enhancing institutional capacity in the transport sector and supporting the fight against HIV/AIDS. The European Union's emergency budgetary assistance focuses on public expenditure management and social sector reforms.

V. Data Issues and Technical Assistance

32. **Madagascar's economic and financial statistics are comprehensive, but exhibit weaknesses for several sectors** (Appendix V). Madagascar has received extensive technical

assistance in the statistics area from multilateral and bilateral donors over the past several years, and has formally begun participation in the General Data Dissemination System (GDDS) in July 2004. A summary of the Fund's most recent technical assistance provision to Madagascar is presented in Appendix III, Section XI. This included, in September 2004, assistance for the development of the foreign exchange market.

VI. Staff Appraisal

33. **Staff considers that the performance under the program is broadly satisfactory, taking into account the impact of the exogenous shocks and corrective actions taken by the authorities**. The growth, fiscal, inflation, and balance of payments performance in 2004 has been adversely affected, but strong measures were taken to secure a tight fiscal and monetary stance. Moreover, efforts to bring tax revenue and net foreign assets—the two indicative targets missed at end-June—back on track over the summer were successful, and progress has been made in structural reforms, albeit sometimes with delay. Economic developments in 2004 highlight the extent to which Madagascar remains vulnerable to external shocks, including cyclones and terms of trade, reinforcing the need for economic diversification and for a flexible policy response.

34. **Inflation has become a key concern for the rest of 2004 and 2005, but the policy adjustments taken should limit second round effects**. The precise evolution of inflation is subject to considerable uncertainties and will depend notably on developments in the international prices of oil and rice—but also on policy responses. In this context, staff welcomes in particular the measures taken to tighten fiscal and monetary policy.

35. **The authorities' fiscal program for 2004 should be consistent with the objective of containing inflation**. Even though revenue performance was disappointing in the first half of 2004, especially at customs, the corrective measures taken by the authorities since July should allow the original program target of 11.2 percent of tax revenue-to-GDP to be met. The prudent current expenditures stance is also welcome, while allowing capital expenditures to increase with cyclone-related rebuilding needs. However, social and political tensions could increase and challenge the determination of the authorities to keep this fiscal stance for the remainder of 2004 and 2005—but perseverance in this area will be critical for macroeconomic stability and a reduction in inflation.

36. **The authorities' fiscal targets for 2005 facilitate a significant decline in inflation while safeguarding spending in priority areas**. Achieving the 2005 objective of reducing the domestic balance by 1 percent of GDP requires a further strengthening of customs administration and rescinding the remaining tax exemptions granted in September 2003. As noted in the PRSP, further improvement in domestic revenue mobilization over the medium term will be crucial for improving the delivery of social services and reducing dependence on foreign aid.

37. **Progress has been made in strengthening the conduct of monetary policy**. Improving liquidity forecasting and management at the central bank is key for the efficient

implementation of the monetary policy. In this regard, particularly welcome is recent progress toward better coordination between the central bank and the ministry of finance, as well as the expansion of monetary policy instruments. Further improvements will be needed to facilitate the conduct of monetary policy at the central bank, including the development of the money market.

38. **Stabilization of the exchange rate over the summer and the introduction of an electronic trading system coincided with a significant drop in interventions by the central bank**. Long-term success of the new system will depend notably on the ability of the central bank to clarify its interventions policy; in this context, the central bank's decision to prepare guidelines for its interventions on the foreign exchange market by end-2004 is welcome.

39. **Maintaining export competitiveness over the medium term is crucial to reach Madagascar's development goals**. To capitalize on improved competitiveness gained with the depreciation of the exchange rate, the authorities will need to improve the functioning of customs, and accelerate the pace of structural reforms, aimed at maintaining low production costs and promoting export diversification.

40. **Madagascar is expected to reach the completion point under the enhanced HIPC Initiative in October 2004**. Good progress has been made in the implementation of the country's poverty reduction strategy, and the strengthening of expenditures tracking mechanism currently underway should help ensure that additional resources freed by debt relief be used with the aim of reaching the MDGs.

41. **Implementation of structural reforms has improved, albeit sometimes with delays**. Progress has been made in enhancing public expenditure management and fight against corruption, although an unfinished agenda remains. Staff also welcomes progress in privatization and the liberalization of petroleum prices. These efforts need to be accelerated, with World Bank support, including improving the efficiency of the utility company.

42. **A major challenge facing the authorities is to strengthen capacity**. Limited capacity continues to jeopardize the government's ambitious reform program. Madagascar's development partners have an essential role to play to help in the capacity-building efforts.

43. **Significant short-term risks to program implementation remain, but these should be set against the broadly satisfactory implementation of the program in 2004 and the authorities' strong ownership of the program targets**. In particular, if inflation is not contained in the coming months, it may trigger political and social instability and prove difficult to contain pressures for further increases of the civil service wages. The balance of payments objectives are also subject to significant risks, including from adverse terms of trade shocks. Overall, staff recommends Executive Board approval of Madagascar's request for waivers for the missed performance criteria at end-March 2004, and the completion of the fifth review under the PRGF-supported program.

Table 1. Madagascar: Tentative Work Program Under the Proposed Revised PRGF Arrangement, 2004–05

Date	Action	Disbursement
August 2004	Mission to continue the discussions for the fifth review under the PRGF arrangement.	
October 2004	Executive Board consideration of the fifth review under the PRGF arrangement and HIPC completion point document.	SDR 11.347 million
December 2004	Mission to conduct the sixth review under the PRGF arrangement and discussions for Article IV consultation.	
February 2005	Executive Board consideration of sixth review under PRGF arrangement, and conclusion of the Article IV consultation. Arrangement expires.	SDR 11.348 million

Table 2. Madagascar: Selected Economic and Financial Indicators, 2001-09 [1/]

10:14 AM 30-Sep-04	2001	2002	2003		2004		2005	2006	2007	2008	2009
			Prog. [2]	Est.	Prog. [2]	Proj.			Projections		
					(Annual percentage change, unless otherwise indicated)						
National income and prices											
Nominal GDP growth	13.7	0.7	13.1	12.8	11.2	16.4	16.2	12.3	11.5	11.5	11.2
Real GDP growth	6.0	-12.7	6.0	9.8	6.0	5.3	7.0	7.0	6.3	6.3	6.0
GDP deflator	7.3	15.3	6.6	2.8	4.9	10.5	8.6	4.9	4.9	4.9	4.9
Consumer price index (period average)	7.0	16.3	8.0	-1.7	5.0	10.1	7.6	5.0	5.0	5.0	5.0
Consumer price index (end of period)	4.8	13.9	7.0	-0.8	5.0	14.9	5.0	5.0	5.0	5.0	5.0
External sector											
Export, f.o.b	20.6	-50.5	56.0	63.0	8.4	-2.4	23.7	9.7	9.4	8.2	7.8
Imports, c.i.f.	5.5	-37.6	45.0	70.3	16.3	8.5	8.3	5.4	6.2	5.1	6.0
Export volume	4.4	-51.2	47.9	51.8	3.4	-1.2	18.1	8.8	8.0	7.2	6.7
Import volume	6.6	-45.3	38.4	70.4	19.7	-5.3	7.6	7.3	6.5	6.7	6.3
Terms of trade (deterioration -) [3]	16.6	-11.0	0.7	7.4	7.8	-13.9	4.1	2.6	1.5	2.4	1.3
Public finance											
Revenue (excluding grants)	-1.3	-20.7	50.5	45.4	28.4	35.0	20.4	14.7	15.4	14.5	14.2
Total expenditure [4]	26.2	-10.5	31.4	40.6	19.9	37.9	12.6	10.8	9.2	7.7	10.3
Current expenditure	28.3	0.9	14.0	24.1	6.6	18.6	11.4	9.3	11.7	12.7	12.8
Investment expenditure and net lending	23.5	-26.6	65.1	72.7	45.4	64.7	13.8	12.4	6.9	2.7	7.5
Money and credit [5]											
Broad money	24.4	7.1	13.4	8.2	12.0	12.6	13.0	14.0	14.5	14.2	14.2
Net foreign assets	29.8	-6.4	26.0	14.9	35.1	59.3	17.7	16.4	24.1	21.0	16.4
Net domestic assets	22.0	13.2	8.6	5.7	2.9	-6.6	9.7	12.1	7.1	8.1	12.0
Credit to government [6]	31.0	32.2	17.0	13.7	-4.7	-34.7	-4.8	-5.8	-7.7	-5.5	-10.7
Credit to the private sector	8.6	-2.6	17.6	22.2	20.7	22.2	22.2	23.0	23.3	23.0	24.0
Velocity of money (M3; average)	4.1	3.8	3.8	4.0	3.8	4.1	4.2	4.2	4.1	4.0	3.9
TB weighted-average auction rates (in percent; end of period)	10.0	12.1	...	10.8	...	...	...	...	...	...	...
					(In percent of GDP)						
Public finance											
Total revenue (excluding grants)	10.1	8.0	10.6	10.3	11.9	12.0	12.4	12.7	13.1	13.5	13.8
Of which : tax revenue	9.7	7.7	10.3	10.0	11.2	11.2	11.8	12.1	12.6	13.0	13.4
Total grants	3.9	2.2	4.3	5.1	5.0	7.9	5.9	5.8	5.6	5.4	5.2
Capital expenditure	7.3	4.8	7.3	7.8	8.2	11.5	11.3	11.3	10.8	10.0	9.7
Total expenditure	17.6	15.7	18.2	19.5	19.6	23.1	22.4	22.1	21.7	21.0	20.8
Overall balance (commitment basis, incl. grants)	-4.3	-5.5	-3.3	-4.2	-2.8	-3.4	-4.1	-3.7	-3.0	-2.1	-1.7
Overall balance (commitment basis, excl. grants)	-8.2	-7.7	-7.6	-9.3	-7.8	-11.3	-10.0	-9.5	-8.6	-7.5	-7.0
Domestic financing	1.9	2.4	0.4	1.8	-0.1	-1.1	0.0	0.0	-0.1	0.1	-0.1
	0										
Money and credit [5]	0										
Broad money	24.7	26.2	26.5	25.1	26.2	24.3	23.7	24.0	24.7	25.3	25.9
Net foreign assets	7.7	7.2	8.1	7.3	9.0	10.0	10.1	10.5	11.7	12.7	13.3
Net domestic assets	16.9	19.0	18.4	17.8	17.3	14.3	13.5	13.5	13.0	12.6	12.7
Credit to government [6]	6.9	9.0	9.3	9.1	8.3	5.1	4.2	3.5	2.9	2.5	2.0
Credit to the private sector	8.4	8.1	8.4	8.8	9.2	9.2	9.7	10.6	11.7	12.9	14.4
	0										
Savings and investment	0										
Resource gap	-3.2	-6.6	-7.6	-10.1	-8.5	-15.2	-11.7	-10.1	-9.2	-8.2	-7.5
Investment	18.5	14.3	17.5	17.9	19.4	23.7	25.3	24.8	24.2	23.3	23.0
Government	7.3	4.8	7.3	7.8	8.2	11.5	11.3	11.3	10.8	10.0	9.7
Nongovernment	11.2	9.5	10.2	10.1	11.2	12.2	14.0	13.5	13.4	13.3	13.3
Gross domestic savings	15.3	7.7	9.9	7.8	10.9	8.6	13.6	14.7	15.0	15.1	15.4
Gross national savings	17.2	8.3	12.9	11.9	13.9	14.6	17.5	18.5	18.6	18.5	18.6
Public	3.0	-0.7	-3.3	3.7	5.4	8.1	7.2	7.7	7.9	7.9	7.9
Private	14.2	9.0	16.2	8.2	8.6	6.4	10.3	10.8	10.7	10.6	10.7
External sector, public debt, and debt service											
Export, f.o.b	21.3	11.0	16.0	15.6	14.5	19.7	23.7	24.0	24.4	24.5	24.6
Imports, c.i.f.	24.7	16.0	23.6	23.9	22.8	33.5	35.2	34.3	33.8	33.0	32.5
Current account balance (excluding grants)	-2.0	-6.1	-7.3	-8.6	-7.6	-13.2	-10.1	-8.6	-7.8	-6.8	-6.3
Current account balance (including grants)	-1.3	-6.0	-4.6	-6.0	-5.4	-9.2	-7.8	-6.3	-5.7	-4.9	-4.3
Net present value (NPV) of external debt [7]											
After traditional debt relief	...	...	...	...	...	71.1	71.7	67.7	64.4	60.8	57.4
After enhanced HIPC Initiative debt relief	...	...	...	...	...	50.6	52.4	50.7	49.1	46.9	44.9
					(In units indicated)						
Gross official reserves (in millions of SDRs)	317.5	266.6	324.0	284.7	400.6	327.5	368.8	421.1	474.3	517.9	564.5
In months of imports of goods and nonfactor services	3.3	4.1	3.5	2.8	3.8	3.0	3.2	3.4	3.7	3.8	3.9
Exchange rate: Malagasy francs per SDR (period average)	8,391.0	8,774.3	...	8,646.0	...	...	...	...	...	...	...
Exchange rate: Malagasy francs per U.S. dollar (period average)	6,591.5	6,592.3	...	6,203.4	...	...	...	...	...	...	...
GDP per capita (in U.S. dollars)	285	278	298	324	339	255	254	269	281	295	307
Nominal GDP (billions of Malagasy francs)	29,843	30,042	33,978	33,893	37,651	39,446	45,822	51,440	57,369	63,982	71,156

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

[1] Data may not add up due to rounding.

[2] IMF Country Report No. 04/91 (3/30/04).

[3] Based on 1993 trade weights.

[4] 2003 includes extrabudgetary expenditure.

[5] The composition of monetary growth in 2003 reflects reclassification of a public enterprise, SOLIMA, debt (FMG 350.4 billion) by the government.

[6] For 2003, include the takeover of SOLIMA debt by the government.

[7] NPV based on stock-of-debt operation at end-2003.

Table 3. Madagascar: Quarterly Central Government Accounts, 2004
(In billions of Malagasy francs)

10:14 AM 30-Sep-04	2004 Q1 Prog.	 Act.	 Q2 Prog.	 Est.	 Q3 Prog.	 Rev. Prog.	 Q4 Prog.	 Proj.
Total revenue and grants	1,325.8	1,358.1	2,981.4	3,035.9	4,760.6	5,858.5	6,381.6	7,826.8
Total revenue	1,090.5	1,077.3	2,309.7	2,283.3	3,326.9	3,420.6	4,491.6	4,717.3
Of which: tax revenue	1,010.5	997.6	2,164.3	2,125.6	3,120.3	3,191.3	4,210.0	4,417.9
Grants	235.3	280.9	671.7	752.6	1,433.7	2,437.9	1,890.0	3,109.5
Current grants	69.0	61.4	228.2	258.5	602.1	1,206.1	781.2	1,450.0
Of which: HIPC assistance	53.3	56.1	92.3	90.8	137.3	138.9	177.2	180.8
counterpart funds	15.7	5.3	28.2	28.2	36.5	36.5	46.3	46.3
Project grants	166.3	219.5	443.5	494.1	831.6	1,231.8	1,108.8	1,659.5
Total expenditure	1,417.6	1,790.7	3,285.3	4,076.6	5,595.9	6,817.4	7,391.7	9,130.4
Current expenditure	957.6	959.6	2,100.4	2,248.8	3,323.0	3,467.7	4,316.0	4,577.2
Budgetary expenditure	914.2	887.0	1,949.5	2,056.6	3,097.9	3,233.2	4,153.9	4,410.9
Personnel [1]	482.8	433.9	965.7	905.4	1,463.4	1,448.5	1,931.3	1,931.3
Of which: HIPC financed	29.9	29.9	59.9	47.5	104.7	89.8	119.7	119.7
Other noninterest expenditure	216.6	193.6	552.9	553.8	1,025.4	944.2	1,344.3	1,277.1
Of which: HIPC financed	13.7	13.7	28.8	16.0	63.0	63.0	84.0	101.8
Foreign interest obligations	71.1	87.9	177.2	256.3	243.1	380.7	377.6	560.7
Domestic interest obligations	143.7	171.6	253.8	341.1	366.0	459.8	500.7	641.8
Treasury operations (net) [2]	41.8	71.3	147.7	190.3	220.6	230.3	156.3	160.5
Counterpart funds-financed operations	1.6	1.3	3.2	2.0	4.5	4.2	5.8	5.8
Capital expenditure	460.0	831.1	1,184.9	1,827.8	2,272.9	3,349.7	3,075.7	4,553.2
Domestically financed	126.7	224.6	309.5	515.7	644.3	870.0	914.4	1,200.0
Of which: cyclone related expenditures	0.0	100.0	0.0	100.0	0.0	100.0	0.0	100.0
Foreign financed	333.3	606.6	875.4	1,312.1	1,628.6	2,479.7	2,161.3	3,353.2
Of which: HIPC financed	23.3	23.3	48.8	56.5	78.9	78.9	95.0	95.0
Government on-lending to public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net cost of structural reforms	-8.1	-22.8	-26.3	-22.8	-38.9	-25.0	-42.7	-42.7
Overall balance (commitment basis)								
Excluding grants	-335.2	-736.3	-1,001.9	-1,816.1	-2,307.9	-3,421.8	-2,942.8	-4,455.8
Including grants	-99.8	-455.4	-330.2	-1,063.5	-874.1	-983.9	-1,052.8	-1,346.3
Domestic balance (commitment basis) [3]	69.3	-41.8	50.6	-247.7	-436.2	-561.5	-403.9	-541.9
Change in arrears [4]	-140.8	-230.0	-175.3	-271.6	-302.0	-287.0	-347.3	-347.3
Total overall balance (cash basis, excluding grants)	-476.0	-966.3	-1,177.2	-2,087.7	-2,609.9	-3,708.8	-3,290.1	-4,803.1
Total overall balance (cash basis, including grants)	-240.6	-685.4	-505.5	-1,335.1	-1,176.1	-1,270.9	-1,400.1	-1,693.6
Financing	240.6	685.4	505.5	1,335.1	1,176.1	1,270.9	1,400.1	1,693.6
Foreign (net)	183.1	540.8	221.5	977.9	939.2	1,534.2	1,367.9	2,005.8
Drawings	303.9	599.2	543.3	1,053.6	1,355.4	1,757.0	1,657.2	2,283.0
Budget	160.3	235.5	160.3	235.6	637.3	588.1	699.7	684.2
Projects	143.6	363.7	383.0	818.0	718.1	1,169.0	957.5	1,598.7
Amortization due	-120.8	-136.9	-321.8	-301.6	-416.2	-517.5	-634.4	-727.2
Change in external arrears [5]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	65.9	78.5	185.2	225.9	226.5	294.7	345.1	450.0
Current maturities	53.5	66.1	122.2	162.9	156.0	224.1	223.7	328.5
HIPC assistance	12.4	12.4	63.0	63.0	70.5	70.6	121.5	121.5
Domestic (net)	55.3	134.5	260.6	230.1	190.9	-390.4	-40.6	-448.3
Banking system [6]	-79.8	-76.3	175.2	-133.2	53.3	-953.9	-151.1	-1,013.4
Nonbanking system	135.1	77.0	85.4	134.0	137.6	438.1	110.5	478.1
Treasury correspondent accounts (net)	0.0	133.8	0.0	229.3	0.0	125.4	0.0	87.0
Privatization receipts [7]	2.2	10.1	23.4	127.1	46.0	127.1	72.8	136.1

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] Personnel expenditures in 2002 were much lower than in the budget as the payment of a number of indemnities and allowances was suspended because of the revenue shortfall.

[2] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, and civil service retirement funds. Beginning in 2002 net correspondent account balances are classified as domestic financing.

[3] Overall balance, excluding grants, foreign-financed capital expenditures, and foreign interest payments.

[4] Change in arrears consists of the amount to be recommitted and net payments delays. The latter includes expenditure committed but with no payment orders issued, a not covered by the performance criterion on non-accumulation of arrears.

[5] Bilateral agreements on debt with non-Paris Club creditors, most of which is in arrears, were initially assumed to be finalized in 2001; however, such reschedulings are materializing at a slower pace than envisaged. For 2001, arrears were rescheduled with the Saudi Fund for Development and a commercial creditor, Itochu Bank (Hong Kong SAR).

[6] Excludes the assumption of state oil company (SOLIMA) debt by the government and the effect of exchange rate changes on net credit to government in foreign exch

[7] Privatization receipts in the first half of 2003 largely came from transactions regarding SOLIMA (FMG 23.5 billion), TORGINOL (FMG 2.04 billion), and FIMA (F

Table 4. Madagascar: Central Government Accounts, 2002-09
(In billions of Malagasy francs)

10:17 AM 30-Sep-04	2002	2003			2004		2005	2006	2007	2008	2009
		Prog.	Proj.	Act.	Prog.	Rev. Prog.	Projections				
Total revenue and grants	3,053.2	5,091.9	4,866.8	5,224.8	6,381.6	7,826.8	8,386.1	9,513.6	10,736.5	12,049.2	13,551.1
Total revenue	2,403.0	3,617.0	3,497.3	3,494.5	4,491.6	4,717.3	5,679.7	6,514.4	7,518.7	8,609.9	9,830.8
Budgetary revenue	2,403.0	3,617.0	3,497.3	3,494.5	4,491.6	4,717.3	5,679.7	6,514.4	7,518.7	8,609.9	9,830.8
Tax revenue	2,304.2	3,509.0	3,389.3	3,392.3	4,210.0	4,417.9	5,423.2	6,224.2	7,228.6	8,317.7	9,534.9
Of which: recovery of tax arrears	…	…	…	…	80.0	80.0	…	…	…	…	…
Nontax revenue	98.9	108.0	108.0	108.0	281.6	299.4	256.5	290.2	290.2	292.2	295.9
Grants	650.1	1,474.9	1,369.5	1,730.3	1,890.0	3,109.5	2,706.4	2,999.1	3,217.8	3,439.3	3,720.3
Current grants	249.6	879.7	817.6	859.3	781.2	1,450.0	1,012.1	1,153.3	1,210.9	1,257.3	1,353.3
Of which: HIPC assistance [1]	183.7	206.3	191.6	191.6	177.2	180.8	327.3	409.7	407.3	388.8	416.5
Project grants	400.5	595.2	551.9	871.0	1,108.8	1,659.5	1,694.3	1,845.8	2,006.9	2,182.0	2,367.0
Total expenditure	4,709.5	6,187.0	6,162.7	6,622.2	7,391.7	9,130.4	10,279.9	11,393.9	12,447.3	13,406.2	14,785.0
Current expenditure	3,109.3	3,544.6	4,047.9	3,858.3	4,316.0	4,577.2	5,098.7	5,571.7	6,224.6	7,017.2	7,916.5
Budgetary expenditure	2,781.1	3,441.4	3,916.9	3,758.2	4,153.9	4,410.9	4,989.7	5,468.7	6,121.6	6,914.2	7,813.5
Personnel [2]	1,380.0	1,815.9	1,887.9	1,827.1	1,931.3	1,931.3	2,287.9	2,469.1	2,696.4	3,007.2	3,344.3
Of which: HIPC financed	71.4	119.8	119.8	119.8	119.7	119.7	176.7	0.0	0.0	0.0	0.0
Other noninterest expenditure	741.7	1,024.3	1,235.3	1,180.7	1,344.3	1,277.1	1,582.3	1,930.6	2,325.3	2,785.3	3,311.0
Of which: HIPC financed	108.0	119.7	119.7	119.7	84.0	101.8	112.3	0.0	0.0	0.0	0.0
Foreign interest obligations	407.7	399.4	346.7	302.8	377.6	560.7	573.7	653.7	687.7	718.8	750.7
Domestic interest obligations	251.8	201.8	447.0	447.5	500.7	641.8	545.8	415.3	412.2	403.0	407.4
Treasury operations (net) [3]	202.0	65.0	91.9	60.4	156.3	160.5	100.0	100.0	100.0	100.0	100.0
Emergency expenditure [4]	122.2	35.0	35.0	35.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which : elections	58.2	35.0	35.0	35.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Counterpart-funds-financed operations	3.9	3.2	4.1	4.3	5.8	5.8	9.0	3.0	3.0	3.0	3.0
Capital expenditure	1,445.8	2,496.3	1,968.7	2,657.4	3,075.7	4,553.2	5,181.1	5,822.2	6,222.7	6,389.0	6,868.4
Domestically financed	559.7	800.0	695.0	861.4	914.4	1,200.0	1,368.8	1,978.6	2,321.6	2,607.4	2,900.4
Foreign financed	886.2	1,696.3	1,273.7	1,796.0	2,161.3	3,353.2	3,812.3	3,843.5	3,901.1	3,781.6	3,968.0
Of which : HIPC financed	121.2	123.7	123.7	123.4	95.0	95.0	261.7	0.0	0.0	0.0	0.0
Government on-lending	154.4	146.1	146.1	106.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance [5]	-46.8	673.6	243.1	386.6	882.4	1,168.9	1,564.6	1,875.8	2,276.0	2,614.2	2,990.0
Overall balance (commitment basis, excluding the cost of structural reforms)											
Including grants	-1,656.4	-1,095.1	-1,295.9	-1,397.4	-1,010.1	-1,303.6	-1,893.8	-1,880.3	-1,710.8	-1,356.9	-1,233.9
Excluding grants	-2,306.5	-2,570.0	-2,665.4	-3,127.7	-2,900.1	-4,413.1	-4,600.2	-4,879.4	-4,928.6	-4,796.3	-4,954.1
Net cost of structural reforms [6]	5.8	-17.1	-20.0	-19.7	-42.7	-42.7	9.0	0.0	0.0	0.0	0.0
Exceptional revenue	5.8	10.0	10.0	6.1	7.3	7.3	9.0	0.0	0.0	0.0	0.0
Cost of structural reforms	0.0	27.1	30.0	25.7	50.0	50.0	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis, including the cost of structural reforms)											
Excluding grants	-2,300.7	-2,587.1	-2,685.4	-3,147.4	-2,942.8	-4,455.8	-4,591.2	-4,879.4	-4,928.6	-4,796.3	-4,954.1
Including grants	-1,650.6	-1,112.2	-1,315.9	-1,417.1	-1,052.8	-1,346.3	-1,884.8	-1,880.3	-1,710.8	-1,356.9	-1,233.9
Domestic balance [7]	-1,006.8	-491.4	-1065.0	-1,048.5	-403.9	-541.9	-205.1	-382.2	-339.8	-295.9	-235.4
Change in arrears	-212.6	-341.6	-256.6	-204.9	-347.3	-347.3	-150.0	-100.0	-50.0	0.0	-50.0
Total overall balance (cash basis, excluding grants)	-2,513.2	-2,928.7	-2,942.0	-3,352.3	-3,290.1	-4,803.1	-4,741.2	-4,979.4	-4,978.6	-4,796.3	-5,004.1
Total overall balance (cash basis, including grants)	-1,863.1	-1,453.7	-1,572.5	-1,622.0	-1,400.1	-1,693.6	-2,034.8	-1,980.3	-1,760.8	-1,356.9	-1,283.9
Financing	1,863.1	1,453.7	1,572.5	1,622.0	1,400.1	1,693.6	2,034.8	1,980.3	1,760.8	1,356.9	1,283.9
Foreign (net)	1,094.2	1,221.0	790.2	957.8	1,367.9	2,005.8	2,025.3	2,005.7	1,837.9	1,320.0	1,260.3
Drawings	1,150.1	1,504.3	1,043.1	1,246.3	1,657.2	2,283.0	2,445.7	2,607.7	2,525.6	2,089.7	2,108.4
Budget	664.4	526.9	321.3	321.3	699.7	684.2	589.3	610.0	631.4	490.2	507.4
Projects	485.7	977.4	721.8	925.0	957.5	1,598.7	1,856.3	1,997.7	1,894.2	1,599.6	1,601.0
Amortization due	-583.1	-661.2	-613.4	-634.4	-634.4	-727.2	-949.9	-961.2	-896.7	-999.7	-1,097.2
Change in external arrears	0.0	-87.7	-71.8	-67.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt relief	527.2	465.5	432.3	413.2	345.1	450.0	529.5	359.2	209.0	230.0	249.1
Of which: HIPC assistance [8]	166.0	156.8	133.7	133.7	121.5	121.5	223.5	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(in millions of U.S. dollars)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	722.6	149.3	710.0	596.5	-40.6	-448.3	-4.5	-25.3	-77.1	36.9	23.6
Banking system [9]	722.1	75.3	225.4	43.9	-151.1	-1,013.4	-96.2	-111.7	-138.1	-91.6	-118.7
Nonbanking system	-71.8	54.0	258.6	422.6	110.5	478.1	91.7	86.4	61.0	128.5	142.3
Treasury correspondent accounts (net) [3]	72.3	20.0	226.0	130.0	0.0	87.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	46.5	83.5	72.3	67.7	72.8	136.1	14.0	0.0	0.0	0.0	0.0
Memorandum items:											
Total HIPC debt relief [10]	349.7	363.2	325.3	325.3	298.7	302.3	550.7	0.0	0.0	0.0	0.0
Extrabudgetary expenditure	…	…	283.0	283.0	…	…	…	…	…	…	…
Total domestic debt	4,236.4	…	4720.4	4,702.9	4,646.8	4,167.6	3,904.0	3,878.7	3,801.6	3,838.5	3,862.0

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] Interim HIPC Initiative assistance of multilateral financial institutions for 2001-04.
[2] Personnel expenditures in 2002 were much lower than in the budget as the payment of a number of indemnities and allowances was suspended because of the revenue shortfall.
[3] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities. Beginning in 2002, net correspondent account balances are classified as domestic financing.
[4] For 2000, the government budgeted FMG 69 billion to address exceptional developments related to the resurgence of a cholera epidemic and the devastating effects of three cyclones early in the year.
[5] Defined as total revenue (excluding non-tax revenues from the central bank) minus current expenditure (excluding domestic and foreign interest payments).
[6] The net cost of structural reforms comprises (a) as receipts, loan recovery by the debt-recovery unit that holds the nonperforming loans of the two (former) public banks (BFV and BTM) after the financial restructuring of their assets; and (b) as expenditures, those related to civil service reform (i.e., training, bonuses, and wage decompression); to the upgrading of pay and equipment in the justice services; to privatization (severance pay, administrative costs, transfers to the regional development fund that provides grants and concessional loans for basic social infrastructure purposes or to employees affected by privatization, and indemnization payments to formerly expropriated owners); and to the capital transfers for the asset restructuring at the two insolvent banks (BFV and BTM).
[7] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.
[8] Interim HIPC Initiative assistance provided through Paris Club flow rescheduling on Cologne terms for 2001-04. It does not include debt relief from multilateral donors after HIPC completion.
[9] Excludes the assumption of state oil company (SOLIMA) debt by the government and the effect of exchange rate changes on net credit to government in foreign exchange.
[10] HIPC grants received plus HIPC external debt relief.

Table 5. Madagascar: Central Government Accounts, 2002-09
(In percent of GDP, unless otherwise indicated)

10:17 AM 30-Sep-04	2002	2003		2004		2005	2006	2007	2008	2009
		Prog.	Act.	Prog.	Rev. Prog.	Projections				
Total revenue and grants	10.2	15.0	15.4	16.9	19.8	18.3	18.5	18.7	18.8	19.0
Total revenue	8.0	10.6	10.3	11.9	12.0	12.4	12.7	13.1	13.5	13.8
Tax revenue (without recovery of tax arrears and additional measures)	7.7	10.3	10.0	11.0	11.0	11.8	12.1	12.6	13.0	13.4
Recovery of tax arrears	…	…	…	0.2	0.2	…	…	…	…	…
Nontax revenue	0.3	0.3	0.3	0.7	0.8	0.6	0.6	0.5	0.5	0.4
Grants	2.2	4.3	5.1	5.0	7.9	5.9	5.8	5.6	5.4	5.2
Current grants	0.8	2.6	2.5	2.1	3.7	2.2	2.2	2.1	2.0	1.9
Of which: HIPC assistance [1]	0.6	0.6	0.6	0.5	0.5	0.7	0.8	0.7	0.6	0.6
Project grants	1.3	1.8	2.6	2.9	4.2	3.7	3.6	3.5	3.4	3.3
Total expenditures	15.7	18.2	19.5	19.6	23.1	22.4	22.1	21.7	21.0	20.8
Current expenditure	10.3	10.4	11.4	11.5	11.6	11.1	10.8	10.9	11.0	11.1
Noninterest expenditure	7.1	8.4	8.9	8.7	8.1	8.4	8.6	8.8	9.1	9.4
Personnel	4.6	5.3	5.4	5.1	4.9	5.0	4.8	4.7	4.7	4.7
Of which: HIPC financed	0.2	0.4	0.4	0.3	0.3	0.4	0.0	0.0	0.0	0.0
Other noninterest expenditure	2.5	3.0	3.5	3.6	3.2	3.5	3.8	4.1	4.4	4.7
Of which: HIPC financed	0.4	0.4	0.4	0.2	0.3	0.2	0.0	0.0	0.0	0.0
Interest obligations	2.2	1.8	2.2	2.3	3.0	2.4	2.1	1.9	1.8	1.6
Treasury operations [2]	0.7	0.2	0.2	0.4	0.4	0.2	0.2	0.2	0.2	0.1
Emergency expenditures [3]	0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: elections	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	4.8	7.3	7.8	8.2	11.5	11.3	11.3	10.8	10.0	9.7
Domestically financed expenditure	1.9	2.3	2.5	2.4	3.0	3.0	3.8	4.0	4.1	4.1
Foreign-financed expenditure	2.9	5.0	5.3	5.7	8.5	8.3	7.5	6.8	5.9	5.6
Of which: HIPC financed	0.4	0.4	0.4	0.3	0.2	0.6	0.0	0.0	0.0	0.0
Government on-lending	0.5	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic budgetary balance	-2.9	-1.0	-2.7	-1.0	-1.3	-0.5	-0.7	-0.6	-0.5	-0.3
Primary balance	-0.2	2.0	1.1	2.3	3.0	3.4	3.6	4.0	4.1	4.2
Net cost of structural reforms [4]	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Exceptional revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cost of structural reforms	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis)										
Excluding grants	-7.7	-7.6	-9.3	-7.8	-11.3	-10.0	-9.5	-8.6	-7.5	-7.0
Including grants	-5.5	-3.3	-4.2	-2.8	-3.4	-4.1	-3.7	-3.0	-2.1	-1.7
Domestic balance [5]	-3.4	-1.4	-3.1	-1.1	-1.4	-0.4	-0.7	-0.6	-0.5	-0.3
Change in arrears	-0.7	-1.0	-0.6	-0.9	-0.9	-0.3	-0.2	-0.1	0.0	-0.1
Total overall balance (cash basis, excluding grants)	-8.4	-8.6	-9.9	-8.7	-12.2	-10.3	-9.7	-8.7	-7.5	-7.0
Total overall balance (cash basis, including grants)	-6.2	-4.3	-4.8	-3.7	-4.3	-4.4	-3.8	-3.1	-2.1	-1.8
Financing	6.2	4.3	4.8	3.7	4.3	4.4	3.8	3.1	2.1	1.8
Foreign (net)	3.6	3.6	2.8	3.6	5.1	4.4	3.9	3.2	2.1	1.8
Drawings	3.8	4.4	3.7	4.4	5.8	5.3	5.1	4.4	3.3	3.0
Budget	2.2	1.6	0.9	1.9	1.7	1.3	1.2	1.1	0.8	0.7
Projects	1.6	2.9	2.7	2.5	4.1	4.1	3.9	3.3	2.5	2.3
Amortization due	-1.9	-1.9	-1.9	-1.7	-1.8	-2.1	-1.9	-1.6	-1.6	-1.5
Change in external arrears	0.0	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt relief	1.8	1.4	1.2	0.9	1.1	1.2	0.7	0.4	0.4	0.4
Of which: HIPC assistance [6]	0.6	0.5	0.4	0.3	0.3	0.5	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	2.4	0.4	1.8	-0.1	-1.1	0.0	0.0	-0.1	0.1	0.0
Of which: banking system [7]	2.4	0.2	0.1	-0.4	-2.6	-0.2	-0.2	-0.2	-0.1	-0.2
Privatization receipts	0.2	0.2	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Total HIPC debt relief	1.2	1.1	1.0	0.8	0.8	1.2	0.0	0.0	0.0	0.0
Education expenditure, after HIPC	2.8	…	…	…	…	…	…	…	…	
Health expenditure, after HIPC	0.9	…	…	…	…	…	…	…	…	
Total domestic debt	14.1	…	13.9	12.3	10.6	8.5	7.5	6.6	6.0	
Nominal GDP (in billions of Malagasy francs)	30,042	33,978	33,893	37,651	39,446	45,822	51,440	57,369	63,982	71,156

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] Interim HIPC assistance of multilateral financial institutions for 2001-04.
[2] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities. Beginning in 2002, net correspondent account balances are classified as domestic financing.
[3] For 2000, the government budgetized FMG 69 billion to address exceptional developments related to the resurgence of a cholera epidemic and the devastating effects of three cyclones early in the year.
[4] The net cost of structural reforms comprises (a) as receipts, loan recovery by the debt-recovery unit that holds the nonperforming loans of the two (former) public banks (BFV and BTM) after the financial restructuring of their assets; and (b) as expenditures, those related to civil service reform (i.e., training, bonuses, and wage decompression); to the upgrading of pay and equipment in the justice services; to privatization (severance pay, administrative costs, transfers to the regional development fund that provides grants and concessional loans for basic social infrastructure purposes or to employees affected by privatization, and indemnization payments to formerly expropriated owners); and to the capital transfers for the asset restructuring at the two insolvent banks (BFV and BTM).
[5] Overall balance, excluding grants, foreign-financed capital expenditures, and foreign interest payments.
[6] Interim HIPC assistance provided through Paris Club flow rescheduling on Cologne terms for 2001-04. It does not include debt relief from multilateral donors after HIPC completion.
[7] Excludes the assumption of state oil company (SOLIMA) debt by the government and the effect of exchange rate changes on net credit to government in foreign exchange.

Table 6. Madagascar: Monetary Survey, 2000-04
(In billions of Malagasy francs, unless otherwise indicated)

1:43 PM 30-Sep-04	2000	2001	2002	2003				2004					
				Mar.	Jun.	Sep.	Dec	Mar.		Jun.		Sep.	Dec.
								Prog. 1/	Act.	Prog. 1/	Act.	Rev. Prog.	Rev. Prog.
Net foreign assets	1,777.1	2,306.9	2,158.6	2,287.2	2,409.8	2,457.9	2,479.3	2,726.5	3,775.8	2,585.6	3,891.9	4,163.7	3,949.0
Net foreign assets (BCM)	1,002.9	1,638.7	1,272.5	1,331.9	1,373.9	1,475.2	1,424.0	1,673.4	2,336.8	1,532.5	2,187.2	2,556.1	2,342.7
Net foreign assets (domestic money banks)	774.1	668.2	886.1	955.4	1,035.9	982.6	1,055.3	1,053.1	1,438.9	1,053.1	1,704.8	1,607.6	1,606.2
Net domestic assets	4,138.0	5,050.3	5,718.4	5,693.9	5,253.6	5,723.4	6,043.4	6,713.4	5,408.1	7,074.8	5,704.2	5,339.2	5,645.5
Domestic credit	4,271.0	5,305.0	5,952.4	5,825.0	5,568.5	5,878.6	6,509.5	6,690.7	6,470.5	7,076.6	6,845.3	6,203.4	6,136.9
Net credit to government (budget) 2/	1,563.3	2,047.8	2,706.8	2,363.1	2,316.3	2,700.6	3,078.4	3,193.1	2,961.8	3,448.1	2,843.3	2,071.1	2,011.6
Other claims on public sector	293.2	429.2	405.4	431.8	397.8	368.8	410.5	368.8	424.2	368.8	429.9	424.8	424.8
Credit to the economy	2,414.5	2,828.0	2,840.3	3,030.1	2,854.3	2,809.2	3,020.6	3,128.7	3,084.5	3,259.7	3,572.1	3,707.6	3,700.5
Credit to public enterprises 2/	111.2	327.2	405.8	409.6	391.1	44.7	46.2	44.7	58.9	44.7	68.3	66.2	66.2
Credit to private sector	2,303.3	2,500.8	2,434.5	2,620.5	2,463.3	2,764.5	2,974.5	3,084.0	3,025.7	3,214.9	3,503.8	3,641.4	3,634.3
Other items (net; asset +)	-133.0	-254.7	-234.0	-131.1	-314.9	-155.2	-466.1	22.7	-1,062.4	-1.8	-1,141.1	-864.2	-491.4
M3	5,915.0	7,357.3	7,877.0	7,981.1	7,663.3	8,181.3	8,522.8	9,439.9	9,183.9	9,660.4	9,596.1	9,502.9	9,594.5
Foreign currency deposits	841.3	773.7	878.9	1,028.0	995.9	1,014.6	1,086.9	1,036.2	1,556.9	1,036.2	1,735.1	1,578.4	1,578.4
M2	5,073.7	6,583.6	6,998.2	6,953.1	6,667.5	7,166.7	7,435.9	8,403.6	7,627.0	8,624.2	7,861.0	7,924.5	8,016.1
Currency in circulation	1,786.6	2,159.6	2,330.1	2,319.8	2,153.9	2,543.0	2,570.0	2,832.0	2,389.6	2,898.1	2,648.8	2,565.8	2,590.5
Deposits in local currency 3/	3,117.8	4,251.2	4,490.7	4,449.8	4,346.2	4,454.1	4,688.7	5,402.0	5,074.2	5,556.4	5,049.0	5,203.0	5,262.9
Short-term obligations of commercial banks	169.3	172.7	177.4	183.5	167.3	169.7	177.2	169.7	163.3	169.7	163.2	155.7	162.6
Memorandum items:				(Percent change since the end of the previous year, unless otherwise indicated)									
M3	19.3	24.4	7.1	1.3	-2.7	4.2	8.2	7.0	7.8	9.5	12.6	11.5	12.6
M2	16.6	29.8	6.3	-0.6	-4.7	2.8	6.3	7.8	2.6	10.7	5.7	6.6	7.8
Domestic credit	16.4	24.2	12.2	-2.1	-6.5	-0.8	9.4	1.9	-0.6	7.7	5.2	-4.7	-5.7
Credit to the private sector	18.9	8.6	-2.6	7.6	1.2	13.6	22.2	7.1	1.7	11.6	17.8	22.4	22.2
Net credit to government 2/	0.2	31.0	32.2	-12.7	-14.4	-0.3	13.7	-2.5	-3.8	5.3	-7.6	-32.7	-34.7
Reserve money	12.4	29.7	4.4	-13.1	-14.2	-0.9	-0.3	6.4	1.5	8.7	-3.9	-2.3	-1.4
Currency/M3 (in percent)	30.2	29.4	29.6	29.1	28.1	30.9	30.2	30.0	26.0	30.0	27.6	27.0	27.0
Reserve money multiplier (M3/reserves)	2.3	2.2	2.2	2.6	2.5	2.3	2.4	2.4	2.6	2.4	2.8	2.8	2.8
Velocity of money (GDP/end-of-period M3)	4.4	4.1	3.8	...	...	...	4.0	...	...	...	...	...	4.1
Exchange rate (Malagasy francs per SDR; end of period) 4/	8,537.8	8,327.5	8,746.0	8,848.4	8,557.3	8,719.1	9,027.0	8,904.7	13,079.9	8,904.7	15,166.5	13,739.3	13,739.3

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

1/ IMF Country Report No. 04//91 (3/30/04). The 2004 program was written based on end-December 2003 projections.
2/ 2003 includes the takeover of state oil company (SOLIMA) debt (FMG 350.4 billion) by the government.
3/ Includes *Comptes de Cheques Postaux and Caisse d'Epargne de Madagascar* deposit accounts.
4/ Exchange rate for monetary programming purposes.

Table 7. Madagascar: Balance Sheet of the Central Bank and Consolidated Balance Sheet of Commercial Banks, 2000-04
(In billions of Malagasy francs, unless otherwise indicated)

1:49 PM 30-Sep-04	2000	2001	2002	2003				2004					
				Mar.	Jun.	Sep.	Dec.	Mar.		Jun.		Sep.	Dec.
								Prog. 1/	Act.	Prog. 1/	Act.	Rev. Prog	Rev. Prog.
Central bank (BCM)													
Net foreign assets	1,002.9	1,638.7	1,272.5	1,331.9	1,373.9	1,475.2	1,424.0	1,673.4	2,336.8	1,532.5	2,187.2	2,556.1	2,342.7
Net domestic assets	1,607.1	1,746.1	2,262.5	1,739.7	1,658.9	2,032.6	2,100.6	2,236.9	1,239.2	2,462.4	1,199.9	889.0	1,132.4
Overall credit to government (net)	1,162.7	1,207.8	1,585.2	884.0	906.3	1,356.4	1,697.4	1,715.2	1,312.1	1,915.2	1,453.2	1,178.8	1,219.4
Liquidity operations 2/	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
Net credit to government (budget) 3/	1,162.7	1,207.8	1,585.2	884.0	906.3	1,356.4	1,697.4	1,715.2	1,312.1	1,915.2	1,453.2	1,178.8	1,219.4
Claims on public enterprises 3/	111.2	276.4	364.1	371.2	362.5	17.8	17.7	17.8	18.2	17.8	19.4	18.1	18.1
Credit to banks	59.5	40.4	27.2	26.5	22.1	21.3	17.2	21.3	16.5	21.3	13.4	15.5	15.5
Other items (net; asset +)	273.7	221.5	286.0	457.9	368.1	637.1	368.3	482.5	-107.6	508.0	-286.0	-323.4	-120.6
Of which : valuation account (losses -)	85.5	-56.0	54.5	20.9	76.3	76.5	-6.9	43.6	-568.7	43.6	-836.3	-754.6	-755.5
Reserve money 4/	2,610.0	3,384.9	3,535.0	3,071.5	3,032.8	3,507.8	3,524.6	3,910.3	3,576.1	3,994.9	3,387.1	3,445.1	3,475.1
Currency outside banks	1,786.6	2,159.6	2,330.1	2,319.8	2,153.9	2,543.0	2,570.0	2,832.0	2,389.6	2,898.1	2,648.8	2,565.8	2,590.5
Bank reserves	823.4	1,225.3	1,204.9	751.8	878.9	964.8	954.6	1,078.3	1,186.5	1,096.8	738.2	879.4	884.6
Currency in banks	78.4	84.9	122.6	102.3	137.5	125.9	150.8	125.9	142.7	125.9	167.5	175.8	175.8
Deposits	745.0	1,140.4	1,082.3	649.4	741.4	839.0	803.9	952.4	1,043.8	970.9	570.8	703.6	708.8
Required reserves (calculated)	...	...	811.0	541.1	530.7	537.5	550.4	646.5	530.5	665.0	0.0		
Excess reserves (calculated)	...	...	271.4	108.3	210.7	301.4	253.5	305.9	513.3	305.9	0.0		
Domestic money banks (DMBs)													
Net foreign assets	774.1	668.2	886.1	955.4	1,035.9	982.6	1,055.3	1,053.1	1,438.9	1,053.1	1,704.8	1,607.6	1,606.2
Net domestic assets	3,354.3	4,529.4	4,660.8	4,706.0	4,473.6	4,655.7	4,897.5	5,554.8	5,355.3	5,709.2	5,242.5	5,329.5	5,397.7
Bank reserves	823.4	1,225.3	1,204.9	751.8	878.9	964.8	954.6	1,078.3	1,186.5	1,096.8	738.2	879.4	884.6
Liabilities to BCM	-59.5	-40.4	-27.2	-26.5	-22.1	-21.3	-17.2	-21.3	-16.5	-21.3	-13.4	-15.5	-15.5
Credit to government (net)	400.6	840.0	1,121.6	1,479.1	1,410.0	1,344.2	1,381.0	1,477.9	1,649.6	1,532.9	1,390.1	892.2	792.2
Purchase of liquidity paper 2/	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
Net credit to government (budget)	400.6	840.0	1,121.6	1,479.1	1,410.0	1,344.2	1,381.0	1,477.9	1,649.6	1,532.9	1,390.1	892.2	792.2
Other claims on public sector	293.2	429.2	405.4	431.8	397.8	368.8	410.5	368.8	424.2	368.8	429.9	424.8	424.8
Claims on public enterprises	...	50.8	41.6	38.3	28.6	27.0	28.5	27.0	40.6	27.0	48.9	48.1	48.1
Credit to private sector	2,303.3	2,500.8	2,434.5	2,620.5	2,463.3	2,764.5	2,974.5	3,084.0	3,025.7	3,214.9	3,503.8	3,641.4	3,634.3
Other items (net; assets +)	-406.7	-476.2	-520.0	-589.0	-683.0	-792.3	-834.4	-459.8	-954.8	-509.8	-855.1	-540.8	-370.8
Deposits	3,959.1	5,024.9	5,369.6	5,477.8	5,342.1	5,468.7	5,775.6	6,438.2	6,631.0	6,592.6	6,784.0	6,781.4	6,841.4
Deposits in local currency 5/	3,117.8	4,251.2	4,490.7	4,449.8	4,346.2	4,454.1	4,688.7	5,402.0	5,074.2	5,556.4	5,049.0	5,203.0	5,262.9
Deposits in foreign currency (time deposits)	841.3	773.7	878.9	1,028.0	995.9	1,014.6	1,086.9	1,036.2	1,556.9	1,036.2	1,735.1	1,578.4	1,578.4
(in millions of SDRs)	98.5	92.9	100.5	116.2	116.4	116.4	120.4	116.4	119.0	116.4	114.4	114.9	114.9
Short-term bonds (liabilities)	169.3	172.7	177.4	183.5	167.3	169.7	177.2	169.7	163.3	169.7	163.2	155.7	162.6

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

1/ IMF Country Report No. 04/91 (3/30/04). The 2004 program was written based on end-December 2003 projections.
2/ Sales of treasury bills for monetary policy purposes.
3/ 2003 includes the takeover of state oil company (SOLIMA) debt (FMG 350.4 billion) by the government.
4/ For 2004, reserve money will be adjusted for changes in the reserve requirement ratio.
5/ Includes *Comptes de Cheques Postaux and Caisse d'Epargne de Madagascar* deposit accounts.

Table 8. Madagascar: Balance of Payments, 2001-09
(In millions of SDRs, unless otherwise indicated)

	2001	2002	2003		2004		2005	2006	2007	2008	2009
10:17 AM			Prog.	Prel.	Prog.	Rev.	Revised Projections				
30-Sep-04						Prog.					
Current account	-46.4	-204.1	-168.6	-234.7	-230.3	-277.6	-241.5	-212.9	-206.4	-190.0	-183.0
Goods and services	-114.3	-224.8	-275.9	-394.1	-360.4	-458.7	-364.2	-339.0	-335.2	-320.1	-316.7
Trade balance	11.6	-90.5	-90.1	-181.5	-225.1	-284.2	-193.6	-172.7	-157.9	-138.6	-129.5
Exports	757.9	375.0	584.9	611.3	613.5	596.4	737.9	809.5	885.5	958.4	1,033.3
Imports	-746.3	-465.5	-675.0	-792.8	-838.6	-880.6	-931.5	-982.2	-1,043.4	-1,097.0	-1,163
Net services (net)	-125.9	-134.3	-185.8	-212.5	-135.2	-174.5	-170.6	-166.4	-177.3	-181.5	-187.2
Services, receipts	276.3	173.1	247.3	228.9	287.8	256.7	287.1	316.7	331.2	351.7	373.9
Services, payments	-402.2	-307.4	-433.1	-441.4	-423.1	-431.2	-457.7	-483.1	-508.5	-533.3	-561.1
Income (net)	-46.7	-53.5	-56.4	-57.0	-47.9	-48.6	-50.8	-52.5	-54.0	-55.6	-57.2
Receipts	18.7	20.1	19.3	11.7	15.7	22.0	20.1	21.0	21.9	22.6	23.3
Payments	-65.4	-73.6	-75.7	-68.7	-63.6	-70.6	-70.9	-73.5	-75.9	-78.2	-80.4
Of which : government interest [1]	-41.4	-43.9	-42.9	-40.5	-42.4	-40.9	-42.1	-42.9	-43.6	-44.0	-44.4
Current transfers	114.6	74.2	163.6	216.4	177.9	229.7	173.6	178.6	182.8	185.7	190.9
Government	24.9	6.2	98.3	102.0	92.9	119.7	73.6	75.6	76.7	77.0	80.0
Budget aid	36.7	22.1	88.8	91.6	82.5	109.3	73.6	75.6	76.7	77.0	80.0
HIPC relief [2]	18.8	20.2	22.2	22.2	19.9	20.3	27.1	26.9	25.8	23.8	24.6
Grants	17.9	1.9	66.7	69.5	62.6	89.0	46.5	48.8	50.9	53.2	55.4
Other (net) [3]	-11.8	-15.9	9.5	10.4	10.4	10.4	0.0	0.0	0.0	0.0	0.0
Private	89.7	68.0	65.3	114.4	85.0	110.0	100.0	103.0	106.1	108.7	110.9
Capital and financial account	65.9	105.1	168.2	208.5	288.2	250.4	257.8	259.4	264.8	237.3	237.3
Capital account (government project grants)	88.6	44.7	63.9	63.8	124.5	124.5	115.0	121.0	127.1	133.5	140.0
Financial account	91.1	24.7	104.2	37.1	163.7	125.9	142.8	138.3	137.6	103.8	97.3
Direct investment	73.1	6.4	13.1	9.1	52.0	30.0	46.7	50.6	54.5	58.7	63.1
Of which : privatization receipts	10.9	3.3	3.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	18.0	18.3	91.1	28.0	111.7	95.9	96.2	87.7	83.1	45.0	34.2
Government	21.5	48.2	96.6	51.3	117.0	105.6	107.0	108.0	103.2	66.7	60.8
Drawing	90.2	120.3	167.6	124.7	186.1	173.6	166.0	171.0	160.0	127.9	125.7
Project drawings	60.4	54.6	105.0	83.5	107.5	122.9	126.0	131.0	120.0	97.9	94.7
Budgetary support	26.8	65.7	56.6	41.2	78.6	50.7	40.0	40.0	40.0	30.0	30.0
Non-government	3.0	0.0	6.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Amortization [1]	-68.7	-72.1	-71.0	-73.4	-69.1	-68.0	-59.0	-63.0	-56.8	-61.2	-64.9
Private sector amortization	-7.3	-8.8	-5.4	-7.0	-5.3	-9.7	-10.8	-20.2	-20.1	-21.7	-26.6
Banks, net	3.8	-21.1	0.0	-16.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (incl. errors and omissions) [4]	-113.8	35.7	0.0	107.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	19.6	-99.0	-0.4	-26.2	57.9	-27.2	16.4	46.5	58.3	47.3	54.3
Financing	-19.6	99.0	0.4	26.2	-57.9	27.2	-16.4	-46.5	-58.3	-47.3	-54.3
Net foreign assets (increase -)	-76.9	40.0	-40.1	-12.1	-96.7	-13.4	-39.1	-70.0	-71.6	-61.4	-69.1
Use of Fund credit (net)	21.4	8.6	17.3	5.9	17.3	29.5	2.3	-17.8	-18.4	-17.8	-22.4
Disbursements	22.7	11.4	22.7	11.3	22.7	34.9	11.3	0.0	0.0	0.0	0.0
Repayments	-1.3	-2.7	-5.4	-5.4	-5.4	-5.4	-9.1	-17.8	-18.4	-17.8	-22.4
Other assets, net (increase -)	-98.3	31.4	-57.4	-18.1	-114.0	-42.9	-41.3	-52.3	-53.2	-43.5	-46.7
Net change in arrears (excluding central bank) [5]	1.6	1.5	-9.5	-9.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief and cancellation [6 7 8]	55.8	57.5	50.0	47.8	38.8	40.6	22.7	23.6	13.2	14.1	14.7
Memorandum items:											
Grants (in percent of GDP)	3.2	1.5	4.4	4.2	5.1	8.1	6.1	5.8	5.6	5.4	5.2
Loans (in percent of GDP)	0.6	1.4	2.6	1.3	2.8	3.5	3.4	3.2	2.8	1.7	1.4
Direct investment (in percent of GDP)	2.1	0.2	0.4	0.2	1.2	1.0	1.5	1.5	1.5	1.5	1.5
Current account (in percent of GDP)											
Excluding net official transfers	-2.0	-6.1	-7.3	-8.6	-7.6	-13.2	-10.1	-8.6	-7.8	-6.8	-6.3
Including net official transfers	-1.3	-6.0	-4.6	-6.0	-5.4	-9.2	-7.8	-6.3	-5.7	-4.9	-4.3
Gross official reserves	317.5	266.6	324.0	284.7	400.6	327.5	368.8	421.1	474.3	517.9	564.5
(in months of imports of goods and nonfactor servic	3.3	4.1	3.5	2.8	3.8	3.0	3.2	3.4	3.7	3.8	3.9
Exchange rates											
Malagasy francs/SDR (period average)	8,391.0	8,774.3	...	8,646.0	...	...	...	...	...	...	...
Malagasy francs/U.S. dollar (period average)	6,591.5	6,592.3	...	6,203.4	...	...	...	...	...	...	...

Sources: Central Bank of Madagascar, Ministry of Finance, IMF Finance Dept., and Fund staff estimates and projections.

[1] Interest and amortization payments assume Paris Club stock-of-debt reduction will occur at the completion point, envisaged to be in 2004.

[2] Interim relief provided by the African Development Bank Group (AfDB), IDA, and the IMF for 2001-03. The distribution of interim relief among these years differs from the original program due to AfDB's choice of a different delivery option than assumed at the time of the decision point.

[3] Other official grants less payments due to scholarships and contributions to international organizations.

[4] Includes commercial credits received or granted.

[5] From 2000 on, includes external commercial arrears.

[6] Bilateral agreements on debt with non-Paris Club creditors, most of which is in arrears, were initially assumed to be finalized in 2001; however, such reschedulings are materializing at a slower pace than envisaged. For 2001, arrears were rescheduled with the Saudi Fund for Development and a commercial creditor, Itochu Bank (Hong Kong SAR).

[7] Assuming a Paris Club flow rescheduling on Cologne terms agreed in 2001, of which a part is attributable to HIPC relief.

[8] Includes SDR 52 million of HIPC relief.

Table 9. Madagascar: Sources and Uses of Resources, 2000-09

9/30/04 10:17 AM	2000	2001	2002	2003 Prog.	2003 Est.	2004 Prog. 1/	2004 Rev. Prog.	2005	2006	2007	2008	2009
								Projections				
					(In billions of Malagasy francs)							
GDP	26,242.1	29,843.1	30,041.9	33,978.2	33,893.2	37,651.3	39,445.5	45,821.7	51,440.0	57,369.5	63,982.5	71,156.3
Consumption	24,216.4	25,281.2	27,729.4	30,599.9	31,245.5	33,564.9	36,067.6	39,597.0	43,866.0	48,755.0	54,295.0	60,177.7
Public	1,790.3	2,489.8	2,449.8	2,943.4	3,108.0	3,437.7	3,374.7	3,979.2	4,502.8	5,124.6	5,895.4	6,758.4
Private	22,426.2	22,791.4	25,279.6	27,656.5	28,137.5	30,127.2	32,692.9	35,617.8	39,363.2	43,630.3	48,399.6	53,419.3
Investment	3,948.1	5,520.9	4,284.8	5,946.3	6,064.5	7,295.3	9,367.2	11,590.5	12,744.2	13,906.2	14,917.7	16,335.3
Domestic investment	3,948.1	5,520.9	4,284.8	5,946.3	6,064.5	7,295.3	9,367.2	11,590.5	12,744.2	13,906.2	14,917.7	16,335.3
Government	1,766.1	2,180.9	1,445.8	2,496.3	2,657.4	3,075.7	4,553.2	5,181.1	5,822.2	6,222.7	6,389.0	6,868.4
Private	2,182.0	3,340.0	2,839.0	3,450.0	3,407.1	4,219.6	4,814.0	6,409.3	6,922.1	7,683.5	8,528.7	9,466.9
Of which: direct foreign investment (flow)	473.5	613.4	56.2	121.9	78.9	463.0	391.7	687.3	771.6	860.5	959.7	1,067.3
Changes in stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Resource gap	-1,922.4	-959.0	-1,972.4	-2,568.0	-3,416.8	-3,208.8	-5,989.2	-5,365.8	-5,170.2	-5,291.7	-5,230.2	-5,356.7
Exports of goods and nonfactor services	8,050.9	8,677.9	4,809.2	7,747.0	7,284.6	8,026.4	11,137.7	15,101.3	17,174.5	19,206.6	21,405.9	23,799.9
Of which : exports of goods	5,625.9	6,359.5	3,290.4	5,444.6	5,300.3	5,463.3	7,786.0	10,872.1	12,344.7	13,978.0	15,658.9	17,476.5
Imports of goods and nonfactor services	9,973.3	9,637.0	6,781.6	10,315.0	10,701.4	11,235.2	17,126.9	20,467.1	22,344.7	24,498.3	26,636.1	29,156.6
Of which : imports of goods	6,329.2	6,262.1	4,084.4	6,283.3	6,874.3	7,467.9	11,496.8	13,723.9	14,978.0	16,470.9	17,923.2	19,667.3
						(In percent of GDP)						
Consumption	92.3	84.7	92.3	90.1	92.2	89.1	91.4	86.4	85.3	85.0	84.9	84.6
Public	6.8	8.3	8.2	8.7	9.2	9.1	8.6	8.7	8.8	8.9	9.2	9.5
Private	85.5	76.4	84.1	81.4	83.0	80.0	82.9	77.7	76.5	76.1	75.6	75.1
Investment	15.0	18.5	14.3	17.5	17.9	19.4	23.7	25.3	24.8	24.2	23.3	23.0
Domestic investment	15.0	18.5	14.3	17.5	17.9	19.4	23.7	25.3	24.8	24.2	23.3	23.0
Government	6.7	7.3	4.8	7.3	7.8	8.2	11.5	11.3	11.3	10.8	10.0	9.7
Private	8.3	11.2	9.5	10.2	10.1	11.2	12.2	14.0	13.5	13.4	13.3	13.3
Of which: direct foreign investment (flow)	1.8	2.1	0.2	0.4	0.2	1.2	1.0	1.5	1.5	1.5	1.5	1.5
Changes in stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Resource gap	-7.3	-3.2	-6.6	-7.6	-10.1	-8.5	-15.2	-11.7	-10.1	-9.2	-8.2	-7.5
Exports of goods and nonfactor services	30.7	29.1	16.0	22.8	21.5	21.3	28.2	33.0	33.4	33.5	33.5	33.4
Of which : exports of goods	21.4	21.3	11.0	16.0	15.6	14.5	19.7	23.7	24.0	24.4	24.5	24.6
Imports of goods and nonfactor services	38.0	32.3	22.6	30.4	31.6	29.8	43.4	44.7	43.4	42.7	41.6	41.0
Of which : imports of goods	24.1	21.0	13.6	18.5	20.3	19.8	29.1	30.0	29.1	28.7	28.0	27.6
Gross domestic savings	7.7	15.3	7.7	9.9	7.8	10.9	8.6	13.6	14.7	15.0	15.1	15.4
Government	4.9	1.8	-0.2	2.0	1.1	2.8	3.0	3.4	3.6	4.0	4.1	4.2
Nongovernment	2.9	13.5	7.9	8.0	6.7	8.1	5.6	10.2	11.1	11.0	11.1	11.2
Current account												
Excluding grants	-6.5	-2.0	-6.1	-7.3	-8.6	-7.6	-13.2	-10.1	-8.6	-7.8	-6.8	-6.3
Including grants	-5.6	-1.3	-6.0	-4.6	-6.0	-5.4	-9.2	-7.8	-6.3	-5.7	-4.9	-4.3
Gross national savings	9.4	17.2	8.3	12.9	11.9	13.9	14.6	17.5	18.5	18.6	18.5	18.6
Government 2/	3.9	3.0	-0.7	-3.3	3.7	5.4	8.1	7.2	7.7	7.9	7.9	7.9
Nongovernment	5.5	14.2	9.0	16.2	8.2	8.6	6.4	10.3	10.8	10.7	10.6	10.7

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

1/ IMF Country Report No. 04/91 (3/30/04).
2/ Defined as overall fiscal balance (on commitment bases, after net cost of restructuring) plus public investment expenditure.

Table 10: Madagascar: Millennium Development Goals

	1990	1995	2001	2002	2015 Target
Goal 1. Eradicate extreme poverty and hunger					
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.					
1. Population below US$ 1 a day (percent)	...	...	49.1	...	
2. Poverty gap ratio at US$ 1 a day (percent)	...	...	18.3	...	
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	6.4	...	
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	40.9	34.1	...	33.1	20.5
5. Population below minimum level of dietary energy consumption (percent)	35.0	40.0	36.0	...	17.5
Goal 2. Achieve universal primary education					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	...	60.6	68.7	...	
7. Percentage of cohort reaching grade 5	21.5	39.7	33.6	...	
8. Youth literacy rate (percent age 15-24)	72.2	76.3	80.8	81.5	
Goal 3. Promote gender equality and empower women					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015					
9. Ratio of girls to boys in primary and secondary education (percent)	98.9	99.2	...	...	100.0
10. Ratio of young literate females to males (percent ages 15-24)	85.6	88.8	92.1	92.5	
11. Share of women employed in the nonagricultural sector (percent)	26.0	...	...	...	
12. Proportion of seats held by women in the national parliament (percent)	7.0	4.0	8.0	8.0	
Goal 4. Reduce child mortality					
Target 5: reduce by two-thirds between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	168.0	156.0	139.0	135.0	54.0
14. Infant mortality rate (per 1,000 live births)	103.0	95.0	86.0	84.0	
15. Immunization against measles (percent of children under 12-months)	47.0	55.0	55.0	61.0	
Goal 5. Improve maternal health					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	580.0	550.0	...	127.0
17. Proportion of births attended by skilled health personnel	57.0	47.3	46.2	...	
Goal 6. Combat HIV/AIDS, malaria and other diseases					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	0.2	...	
19. Contraceptive prevalence rate (percent of women ages 15-49)	16.7	19.4	...	16.9	
20. Number of children orphaned by HIV/AIDS	...	...	6,300	...	
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
21. Prevalence of death associated with malaria	...	...	...	...	
22. Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...	
23. Incidence of tuberculosis (per 100,000 people)	...	...	254.5	...	
24. Tuberculosis cases detected under DOTS (percent)	...	65.0	60.0	61.6	

Table 10: Madagascar: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2015 Target
Goal 7. Ensure environmental sustainability					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources					
25. Forest area (percent of total land area)	22.2	...	20.2	...	
26. Nationally protected areas (percent of total land area)	...	1.9	1.9	2.1	
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...	
28. CO2 emissions (metric tons per capita)	0.1	0.1	0.1	...	
29. Proportion of population using solid fuels					
Target 10: Halve by 2015 proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	44.0	...	47.0	...	72.0
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers					
31. Access to improved sanitation (percent of population)	36.0	...	42.0	...	
32. Access to secure tenure (percent of population)	...	...	...	...	
Goal 8. Develop a Global Partnership for Development 1/					
Target 16: Develop and implement strategies for productive work for youth.					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	
Female	...	...	...	...	
Male	...	...	...	...	
Target 17: Provide access to affordable essential drugs					
46. Proportion of population access with access to affordable essential drugs	...	...	...	...	
Target 18: Make available new technologies, especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	2.8	3.0	13.3	14.0	...
48. Personal computers (per 1,000 people)		1.5	2.6	4.4	...

Sources: World Bank; and Fund staff estimates.

1/ Targets 12-15 and indicators 33-44 are excluded because they can not be measured on a country specific basis. These are related to official development assistance, market access, and the HIPC initiative.

Madagascar: Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending

Actions	Timing (S/M)[1]	Status (FI/II/NS)[2]	Date Achieved	Comments
Actions to strengthen budget formulation				
Define budget aggregates along several poverty categories ("high, medium, or low poverty reduction relevance") of the existing functional budget classification systems, using as much as possible the information on the incidence of expenditures by population poverty groups.	S	NS		Technical Assistance has been requested to help implement the approach.
Derive baseline of budget distribution by poverty classification for most recent year possible.	S	NS		
Migrate Tamatave system from pilot phase to fully operational system based on Oracle, and implement system in three main Treasuries by mid 2005.	M	II		
Draft plan on how the medium-term orientation of the budget can be improved. A multiyear expenditure forecast should be derived from a macroeconomic projection model, be consistent with sectoral policies, and include both current and capital expenditures.	S	II		A draft plan has been initiated through the PRSP and needs to be formalized for the 2005 budget.
Introduce, in stages, a medium-term expenditure planning framework.	M	II		The government is implementing program budgets for all ministries and institutions.
Development of coherent capacity building plan for the Ministry of Finance.	M	II		Continue education of higher level staff (*inspecteurs de trésor, des impôts, et de l'administration financière*) at the Malagasy Institute for Technical Planning.

Madagascar: Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending (continued)

Actions	Timing (S/M)[1]	Status (FI/II/ NS)[2]	Date Achieved	Comments
Actions to strengthen budget execution				
Design and implement a monitoring system for the entire budgetary cycle (*engagement, liquidation, mandatement, paiement*) for at least six ministries of special importance to poverty reduction, including the Ministries of Basic Education and Health.	S	FI		System implemented for the six ministries.
Prepare biannual reports on education and health sector activities at the central and decentralized level, including (i) budgetary allocation and expenditure execution; and (ii) physical achievements.	S	FI		From July 2003 onward, the system covers grants, loans and FCV.
Install and use ASYCUDA ++ software for customs operations in at least six priority sites.	M	II		UNCTAD is currently providing technical assistance and the system should be operational in early 2005.
In the context of the new Organic law on Public Finances to be presented to the Parliament by end-2003, simplify the budget execution structure by combining the functions of the *gestionnaires de crédit* and the *sous-ordonnateurs* in the ministries.	S	FI		
Implement a quantitative study showing what factors are responsible for the slow implementation of the execution of the investment budget in the social sectors.	S	II		Issues have been identified and solutions are being added into budgetary execution notes (circulaires d'execution budgétaire).
Review, update, and simplify the rules and regulations for the complete budgetary cycle (public procurement, inventory assessment, and nomenclature of documentary evidence) based on diagnostic studies, including the Country Fiduciary Assessment.	S	II		The nomenclature of documentary evidence remains to be done.

Madagascar: Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending (concluded)

Actions	Timing (S/M)[1]	Status (FI/II/ NS)[2]	Date Achieved	Comments
Transform the auditor general office into an independent court (Cour des Comptes).	S	II		The organic law was passed by Parliament in July 2004
Actions to strengthen budget reporting				
Publish regularly in the official government journal all *virement des credits* (transfers between credit lines carried out after the budget law is passed by the parliament).	S	NS		
Improve the centralization procedures and consolidation of all balances of the principal treasurers by the central treasury accounting office (ACCT) through the formation of a consolidation and audit unit, constituting a step toward the establishment of general balance sheet statements and of reliable opening and closing accounting balances.	S	FI		The closing balances for 1999-2002 were established.
Strengthen capacity and efficiency of control organs based on recommendations of government report.	S	II		HIPC funds used to strengthen control organs.
Install, by end 2003, the treasury computer system for all main 22 treasury offices.	S	FI	11/01	
Prepare the 2000 and 2001 budgetary execution laws (*loi de règlement*) during 2003.	S	FI		The 2000 budgetary execution law was submitted to the audit court in July 2003 and that of 2001 in December 2003.

[1] S = Short-term action; M = Medium-term action.

[2] FI = Fully implemented; II = Implementation initiated ; NS = Not started.

Antananarivo, September 29, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

1. In the context of the Poverty Reduction and Growth Facility (PRGF) arrangement, approved by the IMF Executive Board on March 1, 2001, the government of Madagascar and Fund staff held the discussions for the fifth review in two stages during the period June 29-July 5 and September 3-10, 2004. The discussions focused primarily on economic and financial developments during the first seven months of 2004, structural reforms under way, and on policies and the economic outlook for the rest of the year and 2005. The first progress report on the implementation of the poverty reduction strategy paper (PRSP) was also discussed, in collaboration with World Bank staff. The broad targets for the macroeconomic and budgetary framework for 2005 were agreed on, but discussions on some details are ongoing with Fund staff and will be further deepened during a mission scheduled for December 2004.

A. Economic and financial developments in the first seven months of 2004

Economic activity, prices, and balance of payments

2. Madagascar was confronted with exceptional exogenous shocks during the first months of 2004. In January, and then again in March, Madagascar was hit by two particularly violent cyclones, which destroyed or damaged more than 1,000 public buildings (including schools and health centers), leaving over 300,000 people without shelter, and affecting agricultural production. During the first five months of 2004, the Malagasy franc (FMG) fell by about 50 percent against the euro. Factors that contributed to the sharp depreciation included: (i) the correction of a previous overvaluation during 2001 through the second half of 2003; (ii) strong imports as a result of higher international petroleum prices, increased government capital expenditures following the cyclones and acceleration of the execution rate, and an acceleration of private imports in response to the tax and tariff exemptions on consumption and durable goods introduced in September 2003; and (iii) weak exports, stemming from the impact of two cyclones on vanilla and shellfish exports and lower than usual repatriation of export proceeds during the first months of 2004. The foreign exchange market reached a turning point in early June, as import demand weakened and a package of fiscal, monetary, and structural policy measures was implemented to contain inflationary pressures and reduce volatility of the interbank foreign exchange market.

3. Inflationary pressures have intensified and constitute a major source of concern. Consumer price inflation accelerated rapidly from around zero at the beginning of the year to over 17.7 percent (on a year-on-year basis) at end-July, reflecting the impact of the cyclones on agricultural output, high international rice and petroleum prices, and the partial pass-through of the depreciation of the currency during the same period. Excluding rice and petroleum, the price of which increased by 42 percent and 66 percent respectively over the period, inflation stood at 6 percent in July 2004 (on a year-on-year basis). Since the beginning of September, the price of rice has started to decrease following actions taken by the government to facilitate distribution and strengthen competition in the rice sector. Following these actions and other important policy adjustments, discussed below, we intend to secure a reduction of inflation to under 15 percent (on a year-to-year basis) in December 2004.

4. Economic growth is expected to be lower than programmed in 2004. Despite a better than expected performance of the Export Processing Zones (EPZs), which are expected to grow by 28 percent in 2004, and of the tourism and construction sectors, real GDP growth is expected to reach 5.3 percent in 2004 (compared with 6 percent under the program), reflecting the adverse impact of the cyclones and the sharp increase in the cost of inputs.

5. Despite these shocks, Madagascar is making good progress in implementing its poverty reduction strategy. The PRSP progress report was submitted to Fund and World Bank staffs in July 2004. It presents, inter alia, results achieved during the past year, lessons learned, challenges facing our policy makers, and an action plan for 2004-05. The PRSP process continues to be participatory and open. An intermediate progress report covering the first six months of implementation was discussed in six regional workshops held between March and May 2004, involving a wide range of stakeholders (including the private sector, donors, NGOs, and government).

6. Three quantitative performance criteria for end-March 2004 have been met, in addition to the three indicative targets. The performance criterion on the floor on net foreign assets was missed, as the central bank was unable to accumulate sufficient foreign exchange in the context of the sharp depreciation of the FMG. The criteria on tax revenue and the ceiling on domestic financing of the government were missed. While our government undertook several steps to rein in non-essential spending, these two criteria were missed, due to increased domestically financed investment expenditures following the two cyclones (amounting to FMG 45 billion) and the negative impact of the cyclones on revenue (estimated at around FMG 30 billion). In addition, the end-March 2004 performance criterion on non-accumulation of domestic arrears was missed by a small margin, following the accumulation of FMG 7 billion arrears vis-à-vis TELMA, the telecommunications company. These arrears were cleared in June, when the privatization of the company was completed. Moreover, the structural performance criterion on the completion of the bidding process for the privatization of the cotton company, HASYMA, was missed. Five companies expressed interest, but only one bid was received, and had to be rejected, since the bidder did not comply with the terms and conditions (in particular, it asked for HASYMA's debt to be taken over by the government). The structural benchmark on the replacement of the existing system

of exchange rate determination by a continuous interbank trading system was missed for technical reasons, as some of the major banks were not ready to move to the new electronic system.

7. At end-June 2004, all quantitative indicative targets were met, except for those pertaining to net foreign assets and tax revenue. The end-June structural performance criterion on the completion of the bidding process for the selection of the company that will manage the sugar company, SIRAMA, was met.

8. In view of the shocks Madagascar faced in the first half of 2004 and the ambitious corrective actions taken, in particular to bring the revenue performance back on track (see below), the government requests a waiver for the nonobservance of the end-March 2004 performance criteria for net foreign assets, tax revenue, net domestic financing of the government, and non-accumulation of domestic arrears. The government also requests a waiver for the nonobservance of the end-March 2004 structural performance criterion for the completion of the bidding process for the privatization of the cotton company, HASYMA. Furthermore, the government wishes to request a modification of the end-September 2004 performance criteria, to reflect the recent macroeconomic developments.

Money and credit

9. The central bank acted to contain the inflationary pressures and reduce volatility on the interbank foreign exchange market. It raised its base rate from 7 to 16 percent in three stages (in April, June, and September) and increased the reserve requirements on demand deposits (from 12 to 15 percent). At the same time, the central bank took other measures, including reducing banks' maximum net open foreign exchange positions from 20 to 10 percent, and lowering the risk concentration limit from 30 percent to 25 percent. In response to these measures, excess liquidity in the banking system decreased sharply. However, banks were able to raise some liquidity by unwinding their stock of Treasury bills.

10. To meet its liquidity objective, the central bank discontinued in July the practice of outright purchase of treasury bills from banks on demand and further tightened monetary policy, by imposing a 15 percent reserve requirement on previously exempted savings and time deposits as well as foreign exchange deposits. The central bank also expanded its intervention instruments. On August 27 and September 16, 2004, it carried out reverse auctions in amount of FMG 170 billion and FMG 265 billion, respectively. As a result of these measures, (i) the foreign exchange market stabilized, notwithstanding very limited interventions by the central bank; and (ii) private sector credit denominated in foreign exchange started to unwind.

11. Interest rates have begun to edge upward. Weighted treasury bill rates rose from 10.7 percent in June to 11.6 percent in July, but remained below ex-post inflation.[8] While two banks responded to the August 27 reverse auctions (with total bids in an amount of FMG 270 billion at interest rates ranging from 13 percent to 13.5 percent), four banks responded to the September auction (with total bids in an amount of FMG 315 billion at interest rates ranging from 13.5 percent to 18 percent).

12. During the first half of the year, M3 grew faster than the program target, reflecting the 17.8 percent increase in credit to the private sector (including the effect of the depreciation on the domestic currency value of credit denominated in foreign currency). Credit in foreign currency increased during the first four months of the year, in conjunction with the financing of vanilla exports, which were delayed because of the cyclones. Credit in local currency also increased, starting in May, in particular those granted to oil companies to finance their imports and short-term credit to enterprises. Reserve money decreased by 3.9 percent during the first half of the year. This was lower than the program target, due to the lower-than-expected accumulation of foreign exchange reserves. Overall, maintaining control over banking sector liquidity and reining in inflation remain central concerns.

Public Finance

13. **Fiscal targets were broadly met during the first six months of 2004, except for fiscal revenue**. The indicative target on domestic financing of the government was met in spite of the impact of the cyclones on domestically financed reconstruction expenditures (which increased by an estimated FMG 90 billion) and on revenue (which decreased by an estimated FMG 42.5 billion). Tax revenue in FMG did not increase despite the sharp depreciation due to the impact of the tax exemptions and persistent weaknesses in tax administration. The government was able to contain non-priority and noninterest current expenditures below the program target, due mainly to a prudent wage policy and the reining in of other non-interest current expenditures. Notwithstanding the surge in inflation and a 16 percent increase in the private sector minimum wage, the government was able to resist demands for a wage hike in the public sector beyond what is included in the 2004 budget.

Structural Reforms

14. The implementation of the government's priority action plan for 2004, which aims at operationalizing the public finance reform program, is well under way. In the fiscal area, the objectives are to strengthen the budget preparation, align the budget closer to PRSP priorities, and improve the budget execution process (with a view to strengthening the tracking of poverty reducing expenditures). Other important reforms that are being implemented include: (i) promulgation of a new legislative framework for public finance;

[8] However, excluding volatile rice and petroleum from the consumer price index, real interest rates remained positive.

(ii) implementation of the recommendations of the independent audit of the Treasury and strengthening of the Treasury accounting system; (iii) comprehensive overhaul of the procurement system (a new Procurement Code was passed by Parliament in July 2004); (iv) strengthening of the internal and external control mechanisms, including increased staffing in the institutions in charge of controlling public entities; and (v) setting up of a specific penal chain for corruption cases, which should help strengthen the judicial system. Public enterprise reforms are discussed in paragraphs 6, 7 above, and 26 below. Governance issues are discussed in paragraph 27. Oil prices were liberalized in July, well before the original target date of end-2004.

15. The government is committed to letting the exchange rate be market determined, and will only intervene on the foreign exchange market to dampen sharp swings in the exchange rate. In this context, the government has introduced a new continuous inter-bank foreign exchange market system in July 2004, and while traded volumes have remained in line with those observed during the same period last year, the central bank has significantly reduced its interventions. Exchange rate volatility was fairly limited, and the new system allows for a continuous quotation not only of the Euro but also of the US dollar, which should help reduce transaction costs. Furthermore, in order to deepen the foreign exchange market, a new decree mandates that all foreign exchange transactions to go through the inter-bank foreign exchange market (MID).

B. Outlook for the Rest of 2004 and for 2005

Public finance

16. The government is committed to implementing a tight fiscal policy, with a view to limiting the second-round effects of the supply-side and exchange rate shocks on inflation and reach the PRSP objective of a 5 percent inflation rate by end 2005 (on a year-on-year basis). To this aim, the government has already taken strong measures, including a 10 percent reduction in non-wage current expenditures, while preserving priority expenditures, and continuation of a prudent wage policy. In particular, no increase in wages nor in benefits beyond those included in the finance law will be granted in 2004. Further, in August 2004, VAT exemptions granted in 2003 on imports of non-investment goods (with the exception of refrigerators and medication) were rescinded, which are expected to increase the revenue in the second half of 2004 by an estimated FMG 60 billion and should help curb the shortfall in fiscal revenue linked to the exemptions.

17. Moreover, additional revenue measures taken to achieve the tax revenue-to-GDP target of 11.2 percent in 2004 include: (i) introduction of anti-corruption measures in the tax and customs departments; (ii) tightening conditions for importers that benefit from a customs duties advance scheme, through the tightening of the eligibility conditions to the scheme and a reduction in its maximum length to one month; (iii) acceleration of customs clearance procedures, notably through an increase in the selectivity of controls; (iv) regular rotation of customs agents (250 agents, equivalent to 25 percent of customs agents, have been reassigned in the last three months, with a view to breaking up some of the corruption

networks); and (v) establishment of performance contracts for customs agents. The tax department has also reinforced its tax recovery efforts, mainly through the acceleration of the recovery of tax arrears, and more systematic information sharing with the public procurement office. These measures have already led to an improvement in revenue performance, as evidenced by preliminary revenue data for July and August, which exceeded original projections by FMG 78 billion and FMG 11 billion, respectively. This indicates that the revenue performance is back on track, and that the targets on tax revenue at end-September and for the year as a whole can be met.

18. Budget execution during 2004 was complicated by the under-budgeting of certain expenditures. Expenditure reallocations in an amount of FMG 101 billion became necessary to ensure that our contractual obligations could be met. The 2005 finance law aims to address this issue in order to avoid the recurrence of similar problems in 2005 (see para. 20 below).

19. Over the remainder of the year, the revenue measures taken so far, coupled with a higher than expected domestic currency value of foreign assistance due to the depreciation of the national currency, would allow for FMG 448 billion (some 1.1 percent of expected GDP) repayment to the domestic financial system. Nevertheless, the domestic balance is expected to worsen slightly, owing to a rise in interest outlays following the increase in the base rate and higher domestically financed capital expenditures in priority sectors (such as education and infrastructure), as the execution rate increased and cyclone-related damages were repaired (overall, almost 1,900 classrooms were built or rebuilt in 2004, and about 550 km of roads constructed).

20. The 2005 budget will adhere to the following broad guidelines. In part due to the phasing-out of domestically financed capital expenditures related to cyclones, and in view of the objective of containing inflation, the domestic balance will be limited to FMG -205 billion, a strengthening of about 1 percent of GDP vis-à-vis the 2004 objective. To achieve this objective, a further gradual increase in the revenue-to-GDP ratio (from 11.2 percent in 2004 to 11.8 percent, consistent with a total objective of FMG 5,423 billion in fiscal revenue, of which FMG 2,683 billion will come from customs revenue) will be required, reflecting the full effect of the tax administration measures taken in 2004, the installation of the most recent ASYCUDA software by UNCTAD (the test phase of the new software is expected to start in December 2004), and the rescinding of remaining tax and tariff exemptions granted in 2003, which is expected in September 2005. Moreover, the following additional measures will be taken: (i) elimination of the customs duties advance scheme (excluding credit for warehouse fees "*crédit d'enlèvement*"), starting in 2005; (ii) reassessment of the specific imports regime; (iii) reassessment of previously granted ad hoc customs exemptions, with a view to reducing them by 20 percent; (iv) mandatory payments of customs duties through the banking system; and (v) elimination of the immunity of customs agents from enquiries and prosecution (Article 4, section 3 of the customs code). These measures are expected to increase fiscal revenue by FMG 216 billion. In addition, customs duties and import taxes will be merged into a single tax starting in 2005. On the expenditure side, the continuation of a prudent wage policy will be required, and the wage bill will be contained to 5 percent of GDP but accommodate increased staffing in priority

sectors (fight against corruption through the setting up of the anti-corruption bureau and increased staffing for the institutions in charge of controlling public entities, judiciary system and customs, creation of new positions to improve domestic security and strengthen the “education for all” program and the health system). Starting in 2005, the Ministry of Defense’s payroll and wage bill will be managed by the Ministry of Finance, as is already the case for the other ministries. Furthermore, nonwage current expenditure will be maintained at 3.5 percent of GDP.

21. Madagascar should continue to benefit from significant external support in 2005, particularly for investment expenditures. Budgetary support is expected to reach SDR 86.5 million (SDR 40 million in loans and SDR 46.5 million in grants). This should enable our government to incur no new net domestic debt in 2005.

Monetary Policy

22. The objectives of monetary policy will be to contain inflation and excess exchange rate volatility. A significant drop in excess liquidity, the recent increase in interest rates on treasury bills, and the recent appreciation of the exchange rate all point to a tightening of monetary conditions. At end-July 2004, three banks have failed to meet the reserve requirements and have been penalized. The monetary program aims for a 12.6 percent increase in broad money (M3) in December 2004 (on a year-on-year basis), consistent with a small increase in velocity from 4.0 at end-December 2003 to 4.1. Given the impact of rising interest rates on velocity and a repayment of FMG 425 billion in statutory advances to the Treasury, reserve money is targeted to decline by 1.4 percent at end-December 2004. The central bank will take additional measures, as needed and in close consultation with Fund staff, to secure the reserve money target and the inflation objective. To manage liquidity, the central bank will further use reverse auctions, should the need arise. The central bank continues to monitor developments on the new continuous interbank foreign exchange market, with a view to improving its efficiency. In this context, the central bank will ensure that it receives all the information required to implement its foreign exchange policy. The Board of Directors of the BCM will issue a resolution establishing the operational guidelines for BCM’s intervention in the foreign exchange market before the end of 2004.

23. The central bank is committed to strengthening its liquidity management and avoiding inconsistency in the use of monetary policy instruments. We welcome and have started to implement Monetary and Financial Systems (MFD) recommendations presented during the June/July 2004 mission. These included: (i) strengthening BCM’s ability to forecast liquidity and foreign exchange cash flow; (ii) widening the BCM’s instruments to manage liquidity, including through the use of standard and reverse auctions, and, in the medium term, after taking account of the budget financing needs, of the securities issued following the conversion of the Treasury’s debt vis-à-vis the central bank into marketable securities; (iii) strengthening coordination between the treasury and BCM. In particular, weekly meetings are now held between officials from the Ministry of Finance and the central bank to assess and update the Treasury financing needs for the period ahead; and (iv) developing the money market. Regarding the latter, commercial banks have already

started to engage in interbank transactions, in order to meet the reserve requirements, as the central bank discontinued its policy of buying treasury bills from banks on demand.

24. Recommendations of the safeguards assessment report are being implemented. The draft law on foreign exchange regulations is expected to be sent to Parliament during its first session in 2005. Significant progress has also been achieved toward the adoption of a new accounting framework and the Ariary as the unit of account starting January 1, 2005. In this context, the new accounting framework for the central bank, as well as for other financial institutions, is expected to be examined by the High Accounting Council in October 2004 to ensure its consistency with accounting rules. Finally, in September 2004, Madagascar requested to participate in the Bank-Fund Financial Sector Assessment Program (FSAP).

Balance of payments and exchange rate

25. For the rest of 2004, uncertainties remain regarding the balance of payments. While imports are declining, there is a risk that continued increases in the international prices of rice and petroleum products and falling vanilla prices on the international market could weaken the balance of payments further. Furthermore, the extent to which recent developments reflect temporary or permanent adjustments in the current account remains unclear. Nevertheless, the government is confident that exports will pick up in response to recent gains in competitiveness, as evidenced by the strong performance of EPZ.

26. The government's trade policy objectives are to improve competitiveness, reestablish the country's reputation as welcoming to foreign investors, and integrate Madagascar into the regional and global economy. To achieve these objectives, the government (i) simplified the tariff structure, lowered the weighted average tariff rate, and reduced the top tariff rate from 33 percent to 25 percent; (ii) exempted imports of capital goods from tariffs; (iii) began reforming customs operations and port procedures; (iv) streamlined procedures for approval of investment projects through the creation of a one-stop counter for foreign investment related formalities; and (v) simplified the cumbersome regulations on subcontracting of EPZ operations to small local firms. The government is also actively participating, with other 15 COMESA members, in negotiations for an Economic Partnership Agreement (EPA) with the EU. Madagascar has officially joined the Southern Africa Development Community (SADC) in August 2004 and preliminary work is ongoing to ensure the country's full integration into this economic zone over the course of 2005. These measures, combined with a market determined exchange rate, are expected to help integrate Madagascar into the world market.

Structural reforms

27. The government's public enterprise reform program is back on schedule. The privatization of the telecommunications company, TELMA, was completed in June 2004. The private company that will manage the sugar company, SIRAMA, was selected at end-June 2004. The government has re-launched the bidding process for the purchase of the cotton company, HASYMA, in early June with World Bank support, and the privatization is

expected to be completed by end-September 2004. Completion of this bidding process is a prior action for Board consideration of the fifth review. The company that will manage the energy company, JIRAMA, is expected to be selected by October 2004. Moreover, the transportation sector was also liberalized and 74 operators were granted preliminary licenses, resulting in a containment of transportation prices, especially in the capital Antananarivo.

28. The government continues to see improving governance as a key policy priority, and some progress has been secured. In particular, new legislation has been passed by Parliament in July allowing for the creation of an independent anti-corruption bureau of 100 agents. The hiring of its staff, especially the general director and the deputy general director, expected in September 2004, is a prior action for Board consideration of the fifth review. The bureau will be responsible for investigating (but not for prosecuting) corruption cases, and will conduct education and prevention campaigns. The government will also conduct independent audits of randomly selected investment projects and of specific public services. Furthermore, the government is committed to improving the operational efficiency of the commercial sections of the lower courts, reinvigorating its judicial reform strategy, and better prioritizing its action plan, with a view to accelerating our judicial reform agenda.

C. Program Monitoring

29. The program supported by the IMF under the PRGF will be monitored through semiannual reviews, and through quantitative and structural performance criteria and benchmarks, indicative targets, and quarterly monitoring indicators (Appendix II, Attachments 1 and 3, attached). Appendix II, Attachment 2 contains the structural performance criteria and benchmarks for the fifth review of the PRGF-supported program. The following measures constitute prior actions for completing the fifth review under the PRGF arrangement: (i) hiring of staff and beginning operation of the Independent Anti-corruption Bureau; and (ii) completion of the bidding process for the privatization of the cotton company, HASYMA.

D. Consultation with the IMF

30. The government believes that the policies set forth herein are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Madagascar will consult with the Fund on the adoption of this measures, and in advance of revisions to the policies contained in our Letter of Intent and its attachments, in accordance with the Fund's policies on such consultation.

Sincerely yours,

Benjamin Radavidson
Minister of Economy, Finance, and the Budget
Antananarivo, Madagascar

Gaston Ravelojaona
Governor
Central Bank of Madagascar
Antananarivo, Madagascar

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets for 2004 under the PRGF Arrangement
(In billions of Malagasy francs, unless otherwise indicated) 1/

12:07 PM 30-Sep-04	2004									
	March Performance Criteria			June Indicative			September Performance Criteria		December Indicative	
	Program 2/	Adjusted	Actual	Program 2/	Adjusted	Actual	Program 2/	Revised Program	Program 2/	Revised Program
I. Quantitative performance criteria										
(a) Ceiling on external arrears (in millions of SDRs) 3/	0.0		0.0	0.0		0.0	0.0	0.0	0.0	0.0
(b) Floor on net foreign assets (NFA) of the central bank 3/ 4/ 5/ 6/	221.8	215.1	166.9	80.9	103.0	-139.9	941.7	1,132.1	869.8	918.7
(c) Ceiling on net domestic assets (NDA) of the central bank 5/ 6/ 7/	23.5	30.2	-176.1	249.0	226.9	13.7	-561.0	-463.8	-455.3	-219.6
(d) Ceiling on domestic financing of the government 7/ 8/	-83.3	-76.6	-2.3	108.7	94.2	68.7	-65.1	-550.3	-315.1	-659.5
(e) Ceiling on contracting or guaranteeing of external debt on nonconcessional terms 9/	0.0		0.0	0.0		0.0	0.0	0.0	0.0	0.0
(f) Floor on tax revenue	1,010.5		997.6	2,164.3		2,125.6	3,120.3	3,191.3	4,210.0	4,417.9
(g) Ceiling on accumulation of domestic arrears	0.0		7.0	0.0		0.0	0.0	0.0	0.0	0.0
II. Indicative targets										
(h) Ceiling on reserve money	236.3		-92.9	320.9		-137.5	371.7	-79.5	405.6	-49.5
(i) Ceiling on broad money (including foreign currency deposits) (M3)	617.6		164.1	838.1		356.9	970.5	980.1	1,058.7	1,071.7
(j) Floor on arrears payments	140.8		230.0	175.3		271.6	302.0	287.0	347.3	347.3
III. Memorandum items:										
(k) Budget support grants and loans (in millions of SDRs)	18.0		18.0	30.1		32.1	119.7	118.7	141.2	139.7
(l) External cash debt service (in millions of SDRs)	8.2		8.9	24.9		25.2	33.6	29.3	55.9	42.4
(m) External privatization proceeds	0.0		0.0	0.0		7.5	0.0	7.5	0.0	7.5
(n) Total privatization proceeds	2.2		10.1	23.4		127.1	46.0	127.1	72.8	136.1
(o) External privatization related costs	0.0		0.0	0.0		0.0	0.0	0.0	0.0	0.0

1/ Cumulative change since end-December.
2/ IMF Country Report No. 04/91 (3/30/04). Note that the original program for 2004 was written based on projections of end-Decerm
3/ Excludes all debt service outstanding that is subject to rescheduling. During the program period, the government will not accumulate any new arrears.
4/ Defined as gross reserves minus all foreign liabilities of the BCM, both long and short term, including use of Fund credit, evaluated at the program exchange rate.
5/ Adjusted for any excess disbursements of external budget support (grants and loans; in millions of SDRs) relative to the cumulative amounts indicated in III.
6/ Adjusted for any deviation from programmed amounts of privatization receipts from abroad, net of privatization-related outlays.
7/ Adjusted for the impact of exchange rate changes.
8/ Defined as bank and nonbank financing plus treasury correspondent account (net), privatization receipts, and net accumulation of arrears.
9/ Excluding normal import-related credits.

Table 2. Structural Performance Criteria and Benchmarks
for the Fifth Review of the PRGF-Supported Program

	Timing	Status
Structural performance criteria		
Submission of draft budget execution laws for 2000 and 2001 to the Audit Court.	By end-December 2003	Done
Completion of the bidding process for the purchase of HASYMA.	By end-March 2004	Not met
Completion of the bidding process for the selection of the company that will manage SIRAMA.	By end-June 2004	Done
No tax or tariff exemptions will be granted beyond those specified in the 2004 budget law.	Continuous	Done
Structural benchmarks		
Publication of the BCM's 2001, 2002, and subsequent financial statements and attendant audit opinions in the *Journal Officiel*, and/or other official outlets and the BCM website.	By end-March 2004	Done
Replacement of the existing system of exchange rate determination by a continuous interbank trading system.	By end-March 2004	Not met

Table 3. Structural Performance Criteria and Benchmarks
for the Sixth Review of the PRGF-Supported Program

	Timing	Status
Structural performance criteria		
No tax or tariff exemptions will be granted beyond those specified in the 2004 budget law.	Continuous	
Issue a resolution approving the newly installed ASYCUDA ++ software and setting a date for the use of the software by customs.	End-December 2004	
Structural benchmarks		
Issue a resolution by the Board of Executive Directors of the Central Bank (BCM) establishing the operational guidelines for BCM intervention in the interbank foreign exchange market (MID).	End-December 2004	
Publish the BCM's complete audited financial statements for 2003.	End-December 2004	
Prior action for Board consideration of the fifth review		
Hire staff and begin operation of the Independent Anti-corruption Bureau.		
Complete the bidding process for the privatization of the cotton company, HASYMA.		

MADAGASCAR

Technical Memorandum on Monitoring the 2004 Program Supported by the Arrangement under the Poverty Reduction and Growth Facility (PRGF)

31. This technical memorandum defines the variables used to establish the quantitative performance criteria and benchmarks for the program, how they are calculated, and any adjustments deemed necessary. It also explains the monitoring variables, that is, anticipated balance of payments assistance and direct investment flows connected with the privatization of public enterprises. Unless otherwise indicated, in the case of stocks, variables for end-June 2003, end-September 2003, and end-December 2003 are expressed as cumulative variations from December 31, 2002 onward, and in the case of flows as cumulative flows from January 1, 2003 onward. Variables for 2004 are expressed as cumulated variations from December 31, 2003 in case of stocks, and cumulated flows from January 1, 2004 onward, in the case of flows. The objectives for end-September 2003 and end-June 2004 are benchmarks; those for end-June 2003, end-March 2004, and end-September 2004 are performance criteria.

I. Quantitative Criteria

A. Ceiling on External Payments Arrears

32. This variable is expressed in terms of the stock of arrears. These arrears will consist of all overdue debt-service obligations (i.e., payments of principal and interest) arising in respect of loans contracted or guaranteed by the government or the Central Bank of Madagascar, (BCM) including unpaid penalties or interest charges associated with these arrears, excluding arrears resulting from nonpayment of debt service for which rescheduling negotiations are under way. This performance criterion should be observed on a continuous basis.

B. Ceiling on Nonconcessional External Borrowing

Definition

33. The nonaccumulation of nonconcessional debt contracted or guaranteed by the government is a performance criterion. Nonconcessional external debt is defined as having a grant element of less than 35 percent. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (IMF Executive Board Decision No. 12274-00/85, August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Under the program, nonconcessional debt includes financial leasing and any other instrument giving rights to a current financial liability, under a contractual arrangement by the government of Madagascar or guaranteed by the government of Madagascar, but it excludes debt contracted under rescheduling agreements and normal import-related credits of less than one year.

Calculation method

34. Calculation of the degree of concessionality of new external borrowing is based on the ten-year average of the OECD's commercial interest reference rate (CIRR) for loans with maturities greater than 15 years and the six-month average CIRR for loans maturing in less than 15 years.

C. Floor for Net Foreign Assets (NFA) of the Central Bank of Madagascar

Definition

35. NFA are defined as the difference between gross international reserves and all foreign liabilities of the BCM, including debt to the IMF and other short- and long-term liabilities of the BCM. Gross international reserves are defined as assets in convertible currency that are readily available to, and controlled by, the BCM for financing payments imbalances, excluding assets that are pledged, collateralized, or otherwise encumbered.

Calculation method

36. For purposes of calculating this criterion, NFA must be converted into Malagasy francs (FMG) at the program exchange rate.

D. Ceiling on Net Domestic Assets (NDA) of the Central Bank of Madagascar

Definition

37. The BCM's NDA include net credit to the government, credit to enterprises and individuals, claims on banks, liabilities to banks in the form of central bank deposit auctions (*appels d'offres négatifs*), and other items net, excluding the foreign exchange adjustment item.

38. Foreign exchange deposits and credits must be converted into Malagasy francs at the program exchange rate.

39. For the purposes of the program, NDA will be adjusted for changes in the reserve requirement in an amount equal to the change in percentage points in the reserve requirement times the amount of deposits held by the public with the commercial banks.

E. Ceiling on the Net Domestic Financing Requirements of the Central Government (CG)

Definition

40. Net domestic financing requirements of the central government are defined as the sum of (a) the variation in the stock of the central government's domestic debt to the banking and nonbanking system, and variation in net debt to treasury correspondents; (b) domestic or

foreign receipts from privatization operations, as defined in Section III.B of this technical memorandum; and (c) the variation in central government domestic arrears. Central government (CG) corresponds to the scope of operations of the treasury as indicated in the overall treasury operations table (o*pérations globales du Trésor,* or OGT). The change in deposits of the treasury correspondents (*correspondants du Trésor)* is considered a component of domestic financing.

41. The variation in the stock of domestic payments arrears consists of the amount to be recommitted and net payments delays (clearings, items in process of payment, and expenditure committed but with no payment orders issued), as defined in the OGT.

42. Net bank claims consist of BCM and commercial bank claims on the CG, including auctioned treasury bills (BTAs) and other treasury bills and liabilities, net of CG deposits with the BCM and commercial banks, including foreign currency deposits. The change in net bank claims is defined to exclude the impact of exchange rate changes on net bank claims on the government.

43. Nonbank claims consist of BTAs and other treasury bills (BTs) and bonds placed with nonbank institutions and the public. The valuation of nonbank claims is based on the change in outstanding conventional treasury bills (maturities of one to five years), auctioned treasury bills (maturities of one month to three years), and outstanding domestic government loans (Lova, Hasimbola, and Fanambina).

Calculation method

44. Net deposits in foreign exchange must be converted into Malagasy francs at the program exchange rate.

45. BTAs must be posted at their net value at time of initial issue.

F. Floor on Tax Revenue

46. Tax revenue includes not only that received by the treasury, but also suspense items, including those related to the public investment program.

G. Ceiling on Accumulation of Domestic Payments Arrears

Definition

47. Payments arrears consist of (1) all expenditure for which payment orders have been issued but have not been paid by the treasury within three months, and (2) the amount of VAT reimbursable to taxpayers which has not been reimbursed after three months.

II. Indicative Limits or Ceilings

A. Ceiling on Reserve Money

Definition

48. Reserve money consists of notes and coins issued and demand deposits of commercial banks with the BCM (including both required and excess reserves).

49. Central bank deposit auctions (*appels d'offres négatifs*) are excluded from reserve money and are classified in NDA.

50. For the purposes of the program, the ceiling on reserve money will be adjusted for changes in the reserve requirement in an amount equal to the change in percentage points in the reserve requirement times the amount of deposits held by the public with the commercial banks.

B. Ceiling on Broad Money

Definition

51. Broad money (M3) includes notes and coins in circulation, demand and time deposits with banks, including foreign currency deposits of residents, and bonds issued by banks.

Calculation method

52. Foreign currency deposits must be converted into Malagasy francs at the program exchange rate.

C. Floor on Payments of Domestic Payments Arrears

Definition

53. Payments of domestic arrears are equal to the variation in the stock of domestic payments arrears defined in paragraph 10, with an opposite sign.

III. Monitoring Variables and Memorandum Items

A. Projected Balance of Payments Assistance

Definition

54. External balance of payments assistance is defined as loans and grants (nonproject) provided as structural adjustment financing and resulting in funds available to the treasury. It

excludes the assistance that gives rise to counterpart funds for the treasury with a delay of longer than one year.

Calculation method

55. Financial assistance in foreign exchange must be converted into Malagasy francs at the program exchange rate. Assistance in kind must be posted when the counterpart funds are deposited with the treasury.

B. Projected Investment Flows Connected with the Privatization of Public Enterprises

Definition

56. The cost of privatization operations is included above the line in central government operations. Apart from covering reform-related costs, **gross receipts from the privatization of public enterprises (PEs)** will be used to reduce outstanding domestic debt.

IV. ADJUSTERS

A. Excess/Shortfall in Balance of Payments Assistance

57. In the event that net external financing (balance of payments assistance less public debt service on a cash basis) exceeds the amount programmed, (a) the floor on the BCM's NFA will be adjusted upward (the adjustment will be converted at the exchange rate used in the operation); (b) the ceiling on the BCM's NDA will be adjusted downward (the adjustment will be converted into Malagasy francs at the exchange rate used in the operation); and (c) the ceiling on the net domestic financing requirements of the central government will be adjusted downward (the adjustment will be converted into Malagasy francs at the exchange rate used in the operation).

58. In the event of a shortfall in net external financing at end-March 2004, end-June 2004, end-September 2004, or end-December 2004 against the programmed amount for the corresponding period of 2004, the floors and ceilings will be adjusted as follows: by a maximum of SDR 11 million for the first quarter of 2004, by a maximum of SDR 17 million for the first half of 2004, and by a maximum of SDR 45 million for the first nine months of 2004 and for the full year of 2004, according to the following method: (a) the floor on the BCM's NFA will be adjusted downward by the amount indicated above (the adjustment will be converted at the program exchange rate); (b) the ceiling on the BCM's NDA will be adjusted upward by the same amount (the adjustment will be converted into Malagasy francs at the program exchange rate); and (c) the ceiling on the central government's net domestic financing requirements will be adjusted upward and capped at the above-mentioned maximum amount (the adjustment will be converted into Malagasy francs at the program exchange rate).

B. Privatization-Related Transactions

59. Adjustments will be made for any deviation in (a) privatization receipts; and (b) current privatization-related expenditure. **The floor on net foreign assets** will be adjusted upward or downward by a maximum of SDR 12 million from the programmed floor if net disbursed foreign resources from privatizations are higher or lower than programmed. The adjustment will be limited to a maximum of SDR 5 million for the periods from end-2002 to end-June 2003, end-September 2003, and end-December 2003. Similarly, the BCM's NDA will be adjusted downward or upward (at the actual average exchange rate of the pertinent quarter). **The ceiling on domestic government financing** will be adjusted to take account of any discrepancies between actual privatization-related expenditures and those programmed (upward adjustment if expenditure exceeds the amount programmed and downward, in the opposite case, up to the difference reported).

C. Program Exchange Rate

60. The amounts of balance of payments assistance and debt service denominated in SDRs will be converted into Malagasy franc at the FMG/SDR exchange rate of FMG 8,904.7 for the first and second quarters of 2004 and FMG 13,739.3 for the third and fourth quarters of 2004. In 2004, corresponding amounts denominated in U.S. dollars and in euros will be converted by applying the rate of US$1.44=SDR 1, and €1.25=SDR 1, and the Malagasy franc/SDR rate indicated above.

V. Consultations with Fund Staff on the Performance Criterion for NFA and the Broad Money Benchmark

61. In the event that demand for money is stronger than expected and the exchange rate appreciates, the central bank should intervene on the interbank foreign exchange market (MID) to offset this appreciation, taking into account programmed limits (floor/ceiling) on the accumulation of net foreign assets and the level of broad money. Given the program limits on these criteria and benchmarks, if broad money growth since end-December 2003 exceeds 15 percent and/or if the level of net foreign assets exceeds the programmed level by more than 5 percent of broad money at end-2003, the authorities will consult Fund staff on measures to be taken in the context of exchange market and monetary policy management.

VI. Information and Data to be Supplied to Fund Staff

62. The Malagasy authorities will provide Fund staff with information and data according to the schedule provided, either directly (e-mail or facsimile) or through the Fund's resident mission.

The Central Bank of Madagascar will report the following statistics:

Monthly

- market results of treasury bill auctions, including the bid level, the bids accepted or rejected, and the level of interest rates;
- data on the secondary market;
- information on monetary developments, as required by the Statistics Department of the International Monetary Fund (STA);
- monthly balances of the BCM and deposit money banks;
- bank lending by economic sector and by term;
- the banking risk situation;
- money market operations and rates;
- changes in bank liquidity on an end-of-month basis (required reserves and free reserves);
- the foreign exchange cashflow table, including foreign debt operations;
- the table of interbank foreign exchange operations on the MID; and

Quarterly

- data on foreign trade (exports and imports).

63. **The Ministry of Economy, Finance, and Budget will report the following information:**

Weekly

- weekly report of the customs and tax directors to the committee monitoring the customs and tax administration reforms.

Monthly

- OGT data on a cash and commitment basis and the related tables;
- expenditure on structural reform;
- central government revenue and expenditure, including short-term treasury on-lending;

- treasury liabilities (statutory advances and operations on the treasury bill market);
- central government capital expenditure;
- external public debt operations (debt contracted and publicly guaranteed, settlement of arrears, and operations of public enterprises) and debt service paid;
- the consumer price indices; and
- indicators of sectoral economic activity.

64. Moreover, information on important measures adopted by the government in the economic and social areas that would have an impact on program development, changes in legislation, including laws passed by the National Assembly and new rules established by the Banking Supervision Commission (CSBF), and any other pertinent legislation will be reported to Fund staff on a timely basis for consultation or information, as appropriate.

/s/

Gaston Ravelojaona
Governor
Central Bank of Madagascar
Antananarivo, Madagascar

/s/

Henri Bernard Razakariasa
Secretary General
Ministry of Economy, Finance, and Budget
Antananarivo, Madagascar

Madagascar: Relations with the Fund
(As of August 31, 2004)

I. Membership Status: Joined 9/25/63; Article VIII

II. General Resources Account:

	SDR Millions	% Quota
Quota	122.20	100.00
Fund holdings of currency	122.17	99.98
Reserve position in Fund	0.03	0.02

III. SDR Department:

	SDR Millions	% Allocation
Net cumulative allocation	19.27	100.00
Holdings	0.09	0.48

IV. Outstanding Purchases and Loans:

	SDR Millions	% Quota
Poverty Reduction and Growth Facility (PRGF) arrangements	136.79	111.94

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR millions)	Amount Drawn (SDR millions)
PRGF	03/01/01	03/01/05	91.65	68.96
ESAF/PRGF	11/27/96	11/30/00	81.36	78.68
ESAF	05/15/89	05/14/92	76.90	51.27

VI. Projected Payments to Fund (without HIPC Initiative Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	2.71	8.14	16.87	17.56	17.12
Charge/interest	0.43	1.03	0.96	0.87	0.79
Total	3.14	9.16	17.83	18.43	17.91

Projected Payments to Fund (with Board-approved HIPC Initiative Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	2.71	8.14	16.87	17.56	17.12
Charges/interest	0.43	1.03	0.96	0.87	0.79
Total	3.14	9.16	17.83	18.43	17.91

VII. Implementation of HIPC Initiative:

Commitment of HIPC Initiative assistance	Enhanced framework
Decision point date	12/21/2000
Assistance committed (NPV terms)	
Total assistance (US$ Million)[9]	814.00
Of which: Fund assistance (US$ million)	21.60
(SDR equivalent in millions)	16.60
Completion point date	Floating

Disbursement of IMF assistance (SDR million)

Assistance disbursed to the member	5.62
Interim assistance	5.62
Completion point balance	--
Additional disbursement of interest income[10]	--
Total disbursements	5.62

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the Central Bank of Madagascar (BCM) is subject to a full Stage One safeguards assessment with respect to the PRGF arrangement, which was approved on March 1, 2001 and is scheduled to expire on November 30, 2004. An off-site safeguards assessment of the BCM was completed on November 21, 2001. The assessment concluded that an on-site assessment was not necessary, but identified certain weaknesses and made appropriate recommendations. These weaknesses are being addressed with the assistance of MFD, but key recommendations such as the publication of the BCM financial statements, the development and implementation of an action plan to move the BCM's existing accounting framework to International Accounting Standards (IAS), and the disclosure of the differences between the existing accounting framework and IAS remain to be implemented.

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[9] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point.

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

IX. Exchange System and Exchange Rate Arrangements:

After April 1982, when the peg to the French franc was discontinued, the exchange rate was managed with reference to a basket of ten currencies. However, by end-1991, the authorities ceased the practice of adjusting the exchange rate to offset inflation differentials with key trading partners. Since July, 2004, the Malagasy franc has been determined through a continuous interbank foreign exchange market system. The exchange rate in terms of the SDR at end-August 2004 was FMG 14,914.7 = SDR 1.

Madagascar accepted the obligations under Article VIII, Sections 2(*a*), 3, and 4 on September 18, 1996 and maintains no restrictions on the making of payments and transfers for current international transactions.

X. Last Article IV Consultation:

Madagascar's consultation cycle is governed by the decision approved by the Executive Board on July 15, 2002. This decision stipulates that, subject to certain exceptions, an Article IV consultation with a member receiving financial assistance under a Fund arrangement is expected to be completed within 24 months of the conclusion of the previous Article IV consultation. The 2002 Article IV consultation discussions with Madagascar were held during October 7-12 in Antananarivo and during November 11-13 at headquarters. The staff report was discussed by the Executive Board on December 23, 2002.

XI. Technical Assistance:

Department	Dates	Purposes	Results of Missions
FAD	July-August 1994	Assess the decline in the country's tax effort and recommend measures to mobilize additional revenue.	Elimination of all ad hoc tax exemptions, beginning with the 1995 budget, recommended.
FAD	September 1995	Assess the need for reforming the value-added tax (VAT) and develop a strategy to improve tax and customs administration.	Broadening of the VAT base and the creation of a special office for the monitoring of transactions in the free export zone recommended.
FAD	September 1996	FAD advisor to assist the authorities in implementing the recommendations of FAD September 1995 mission. Assignment extended to March 1998.	The large-taxpayer unit established. Implementation of VAT reform continued.

Department	Dates	Purposes	Results of Missions
FAD	December 1997	Review existing tax incentives and prepare action plan to improve the performance of the tax and customs departments.	Program proposed to curtail exemptions and implement an exemption-monitoring scheme.
FAD	February 1998	Hold follow-up discussion on tax and tax administration reform program.	Schedule for the preparation and implementation of key measures established.
FAD	March 1998	Examine and assess budgetary expenditures, control, and management.	Comprehensive report prepared for the reform of budget planning, execution procedures, and control systems.
FAD	April 1998	Review important issues to be addressed in the area of customs administration.	Agenda for follow-up mission identified (July 1998).
FAD	June 1998	Conduct follow-up visit on expenditure control.	Action plan, based on the report of the FAD mission of March 1998, established.
FAD	May, September, and December 1998 and April, May, and June 1999	Hold follow-up discussions on tax and tax administration reform.	Assistance for the revision of the VAT law provided, and a VAT reimbursement system introduced for free export zone producers.
FAD	July 1998	Identify measures to strengthen customs administration.	Report prepared on duty assessment and collection procedures, the coordination between the preshipment inspection company and the customs department, the computerization strategy, and organizational issues.

Department	Dates	Purposes	Results of Missions
FAD	January 1999	Help implement earlier FAD recommendations on improving public expenditure management.	Aide-mémoire prepared on progress in harmonization of budget and treasury classifications, computerization of treasury offices, implementation of a cash management and financial plan, and implementation of a budget and accounting classification for the decentralized budget.
FAD	June 1999	Strengthen tax audit system of large-taxpayer unit.	Action program developed and agreed with the authorities.
FAD	February-March 2001	Examine and assess budgetary control and management.	Comprehensive report prepared for the reform of budget planning, execution procedures, and control systems.
FAD	January-February 2003	Examine and assess tax and customs administration.	Comprehensive action plan and report on establishment of an oversight committee prepared.
FAD	July-August 2003	Examine and assess tax policy and assist in tax policy design.	Comprehensive action plan and report on next steps prepared.
FAD	May-June 2004	HIPC Assessment and Action Plan (AAP).	The mission is in the field.
MFD	August 1993–99	Assign a bank supervision advisor and assist in the adoption of an interbank foreign exchange market.	Supervisory agency strengthened.
MFD	April-May 1994	Review the modalities for liberalizing the exchange regime and accompanying monetary and credit measures.	Interbank exchange market adopted in May 1994. Central bank base rate and reserve requirements increased.

Department	Dates	Purposes	Results of Missions
MFD	May 1995	Review interbank foreign exchange market, develop indirect instruments of monetary management, and reduce banks' excess reserves.	Recommendations adopted during the second half of 1995.
MFD	October-November 1998	Assess the operation of the foreign exchange and treasury bill markets; introduce the euro quotation currency.	Recommendations for treasury bill market adopted in November 1998.
MFD	December 1998	Prepare the change to the euro as pivot currency.	Euro introduced as scheduled.
MFD	May-June 1999	Prepare for introduction of continuous-quotation foreign exchange market, including procedures manual and market rules.	To be implemented by end-2003.
MFD	October-November 1999	Assess exchange regulations and compliance with the Basel Core Principles for effective banking supervision.	Recommendations on banking regulation to be adopted.
MFD	November-December 2002	Assess progress in the implementation of the Core Principles for effective banking supervision; and examine the early warning system for detecting bank failures.	Recommendations being implemented.
MFD	November 2002	Take an inventory of microfinance institutions and define a strategy for their supervision.	Recommendations being implemented.
MFD	November 2002	Assess management of foreign reserves and propose concrete steps for its improvement.	Recommendations being implemented.

Department	Dates	Purposes	Results of Missions
MFD	March 2003	Review central bank internal audit functions.	Awaiting final report.
MFD	March 2003	Review microfinance regulation.	Awaiting final report.
MFD	June 2003	Review currency reform.	Recommendations being implemented.
MFD	September 2004	Review operations of the newly installed interbank foreign exchange market.	The report is being finalized.
STA	October 1995	Review money and banking statistics.	Recommendations for data improvements adopted.
STA	June 2001	Review balance of payments compilation system.	Recommendations for improvements accepted and being adopted.
STA	July-August 2001	Review money and banking statistics.	Recommendations for data improvements accepted and being adopted.
STA	February 2004	Multisector statistics mission.	The report is being finalized.

XII. Resident Representative:

Madagascar has had a Fund Resident Representative since September 1989. Mr. Samir Jahjah took up the post of Resident Representative at end-September 2003.

Madagascar: Relations with the World Bank

(As of August 2004)

Partnership in Madagascar's Development Strategy

1. The Government's poverty reduction strategy (PRSP), was endorsed by the World Bank and IMF Boards in November 2003. The Strategy outlines a framework for the Government to redouble its efforts to implement a new generation of economic and social reforms The Strategy was developed over three years, starting under the previous administration and continued by the new Government. The overarching goal of the PRSP is to cut the poverty rate by half in ten years, from 70 percent in 2003 to 35 percent in 2013. To reach this objective the Strategy, based on the principle of public private partnership, has three main axes (i) restoring a rule of law and a well governed society; (ii) promoting economic growth with a large social base, and (iii) promoting systems for establishing human security and enlarging social protection. Fifteen policy areas and corresponding measures, proposed outputs and expected outcomes underpin these strategic axes. The main areas are to improve governance, create a business friendly environment for investment and accelerate private sector led growth and improve social service delivery to the benefit of its citizens.

2. A summary of IMF-World Bank collaboration in Madagascar is provided in Table 1. The IMF leads in supporting Madagascar's medium-term program for maintaining macroeconomic stability. In March 2001, the IMF approved a Poverty Reduction and Growth Facility (PRGF) which extends until March 2005. The goal of the PRGF is to support Madagascar's efforts to foster macroeconomic stability, promote accelerated growth, improve social services, and reduce poverty. It focuses on strong fiscal consolidation to lower public debt and structural reforms including: (i) monetary policy and financial sector reform; (ii) improvement in tax administration; (iii) restructuring/privatization of public enterprises; and (iv) trade reforms.

3. The World Bank leads the policy dialogue in structural and institutional reforms aimed at: (i) strengthening governance in the public sector; (ii) accelerating pro-poor economic growth and supporting foreign investment and private sector development; and (iii) ensuring human development and security, such as in health and education.

Bank Group Strategy and lending operations

4. The World Bank's FY04-06 Country Assistance Strategy (CAS) for Madagascar is fully aligned to the Government's program, and refocuses the existing portfolio to better align itself to the PRSP objectives and to address the key constraints to broad based growth. It also proposes new projects for transport, environment and governance in FY04, an Integrated Growth Poles project for FY05 addressing infrastructure and private sector development; and a watershed management project in FY06. The CAS also reflects a gradual transition from investment to programmatic lending with annual Poverty Reduction Credits (PRSC) foreseen after FY05. The first Poverty Reduction Support Credit (PRSC) addressing governance, education and nutrition was approved in July 2005. A second PRSC would follow in FY06. Recently completed and ongoing analytical work such as a Rural and Environment Sector Review, a Tourism Study, a

Poverty Assessment, financial management and public procurement reviews, a Public Expenditure Review, and a Development Policy Review provide the foundation for programmatic lending and policy dialogue.

5. The Bank's current portfolio consists of 16 projects with total commitments of around US$857 million, of which about US$417 million was disbursed as of August26, 2004. Of these total current commitments, around 48 percent are in infrastructure, transport, energy and mining, about 32 percent in the social sectors, 12 percent in rural development and rural water, 5 percent in finance and private sector development, and 3 percent in targeted governance support.

IMF-World Bank Collaboration in Specific Areas

Areas where the Bank takes the lead

7. Areas in which the World Bank takes the lead are related to specific sector advice in the areas in which the Bank has active lending operations (especially in the social sectors, infrastructure, agriculture and environment) as well as through a number of analytical studies as described above. Together with the Government and other donors, the Bank is also involved in supporting aid coordination. This has included mobilizing US$2.3 billion over a period of four years for Madagascar's reconstruction and development program financing following the 2002 crisis, and mobilizing donor support for implementing the Government's PRSP and to the Education for All initiative.

Areas in which the IMF takes the lead

8. Areas where the Fund takes the lead role relate to policy advice and reforms with respect to (i) overall macroeconomic policies and targets; (ii) tax policy and administration; (iii) budgetary accounting; (iv) treasury procedures; (v) public sector wage policy; and (vi) monetary management and exchange rate policy (including the changeover from the Malagasy franc to the new currency, the Ariary). The Bank team actively participates in discussions between the Fund and the government in all these areas, however, especially with respect to the setting of overall macroeconomic targets as well as tax policy.

Areas of Joint Responsibility

9. IMF and World Bank staff maintain a close working relationship, especially with respect to (i) monitoring the Poverty Reduction Strategy Paper; (ii) reforms set out at the decision point of the Highly Indebted Poor Countries Initiative; (iii) analyses and reforms in public financial management; (iv) other governance reforms, including customs; (v) support of the privatization program; and (vi) participation in the integrated framework trade initiative. Joint policy advice between the Bank and the Fund is given on (i) budgetary procedures, including expenditure execution; (ii) the functioning of internal and external budget control institutions; and (iii) monitoring and continuation of the privatization program. Table 1 includes a short description of each of the areas and specific support from the two institutions with respect to policy advice.

TABLE 1: BANK/FUND COLLABORATION

Area	***Description***	***Specialized Advice/ Reforms Supported by Fund***	***Specialized Advice/ Reforms Supported by Bank***
Completion of full PRSP	Together with multi- and bilateral donors, Bank/Fund provided continuous technical assistance toward completion of full PRSP in 2003	Macroeconomic framework: growth, revenue, expenditure, trade projections	Poverty analysis; rural poverty study; education and health sector work
HIPC completion point reforms	Regular joint Bank/Fund supervision missions; joint preparation of HIPC 'Tracking Poverty-Related Spending' assessment and action plan	Reforms linked to budgetary accounting and controls	Reforms in education, health, rural transport sector
Public financial management	Joint Bank/Fund missions analyzing fiscal management	Tax analysis and reform, strengthening control organs; expenditure management	Budget formulation, expenditure monitoring and analysis, especially in sectors important for poverty reduction; procurement, strengthening internal and external controls.
Other governance reforms	New Government has embarked on large governance reform agenda; Bank/Fund staff work closely with UNDP/EU/AfDB staffs on assisting development of implementation plans	Customs	Anti-corruption agenda, decentralization, judicial sector reform
Privatization Program	Close joint monitoring of Government's large privatization program comprising four major and several dozen smaller public enterprises	All sectors, especially monitoring of privatization receipts of large enterprises (petroleum, telecom)	All sectors. .
Integrated Framework/ Trade Analytical Work	Integrated Framework paper FY04	Macro projections for IF framework paper	Sectoral analysis for IF framework paper

10. Questions may be referred to Mr. Willem van Eeghen (473-2399), Country Program Coordinator for Madagascar at the World Bank.

Madagascar: Statistical Issues

1. Madagascar's database remains weak, particularly the real sector, government finances, the balance of payments, and social indicators. The authorities are aware of these deficiencies and are working, with technical assistance from the international community, including the Fund, to strengthen their statistical system. Madagascar is a participant in the General Data Dissemination System (GDDS), and its metadata have been posted on the DSBB as of May 20, 2004). STA balance of payments and monetary and financial statistics technical assistance missions visited Antananarivo in June and July 2001, respectively. Following a request by the authorities, a multisector statistics mission was fielded during February 12-25, 2004.

Real sector

2. Production of a complete set of national accounts (benchmark data) is infrequent and depends largely on the availability of source data, whose collection is irregular. The last set of accounts was produced for 1995 and 1984. For the intermediate years, only estimates of GDP at current and constant (1984) prices broadly following the *1968 SNA* are produced. These estimates are revised frequently and are considered unreliable, owing to the scarcity of source data, or their inadequate use, and to methodological shortcomings. In particular, the estimates of the agricultural activities are weak because of the unavailability of suitable information about the size and the evolution of this sector. Moreover, service activities are not properly covered and little information is available on the magnitude of the informal sector. The INSTAT envisages passage to the *1993 SNA* by implementing the ERE/TES software designed for compilation of national accounts and by changing the base year from 1984 to 2001. Significantly, in January 2002, the publication of a quarterly index of industrial production by export processing zone (EPZ) enterprises was introduced, with external technical and financial assistance. There are plans to begin developing a quarterly industrial production index (covering non-EPZ enterprises), should discussions concerning United Nations Development Program (UNDP) financial assistance be completed early.

3. A revamped consumer price index (CPI), with weights based on the 1993 household survey and covering four principal cities, was introduced in July 2000. The CPI is generally reported to Fund staff on a timely basis. Data on producer prices and nationwide employment are not available. Various considerations drive the ongoing work on the wholesale price index (WPI) renewal—the key issue being the relative importance of the commercial activities in the Malagasy economy. However, the utility of such an indicator is reduced due to the limited coverage of manufacturing products.

Government finance

4. The latest government finance statistics (GFS) data reported to STA for publication in the *GFS Yearbook* are for 2002 and cover the consolidated central government. However, many classification problems remain (requiring extensive use of adjustment entries to current

expenditure), and detailed information is missing in the time series since 1996 for budgetary and nonbudgetary breakdowns and for central government debt. Madagascar does not report subannual data for publication in *International Finance Statistics.*

Balance of payments

5. Since 1984, the Central Bank of Madagascar (BCM) has been in charge of compiling and disseminating balance of payments statistics, and in 1997 it implemented the fifth edition of the *Balance of Payments Manual* (*BPM5)*. However, the current compilation system is flawed in many respects: the external trade data are derived from customs data, which suffer from inadequate coverage and deficient recording procedures. Moreover, significant smuggling activities, particularly related to the in the mining sector, further reduce the reliability of recorded trade data. Because the customs processing system has experienced numerous technical disruptions since 1998, the external trade data have limited serviceability and require many manual corrections. The current implementation of the ASYCUDA (automated system for customs data, Version 2.7) was largely completed by mid-2002, with the system installed in most customs offices. There are plans to further upgrade the customs processing system to ASYCUDA ++.

6. The multisector technical assistance mission reviewed the progress made in the transition to *BPM5* and found that the authorities had implemented the surveys to direct investment enterprises, using an upgraded international transactions reporting system (ITRS), although the results have yet to be incorporated in the balance of payments. The mission noted that the compilation system is still hampered by several recurring issues: excessive processing lags due to partial automation of customs reports, inadequate coverage, for example, for transactions and debt of the private sector, NGOs, foreign embassies in Madagascar, and transaction misclassification, e.g. debt relief obtained from multilateral financial institutions is recorded in current transfers instead of in capital transfers.

7. In addition, the export processing zones (EPZ) that process goods and reexport to a third economy are not properly identified within other business services (merchanting and other trade related services).

8. The present compilation system offers wide leeway to use available data. This is exemplified by the c.i.f./f.o.b. correction indicator of 15 percent, that is entirely attributed to freight, while ASYCUDA and port authorities can provide separate data for freight, insurance and other categories. Data for the service and income accounts rely excessively on the ITRS reports, whose accuracy is not routinely assessed against other data sources.

9. As noted by the technical assistance mission in June 2001, the INSTAT and the BCM adjust differently customs data using different techniques and publish two distinct series of trade statistics hampering the reliability of Madagascar's external transactions.

10. The compilation of external debt statistics is generally satisfactory, and the authorities are benefiting from technical assistance by the United Nations Conference on Trade and Development (UNCTAD) in installing the latest version of the Debt Management and Financial Analysis System (DMFAS). This system is not yet fully operational; some data entry remains to be completed, and certain DMFAS modules remain to be installed by UNCTAD technicians.

Monetary statistics

11. A STA monetary and financial statistics mission visited Antananarivo in July 2001. The 2001 mission found that the BCM implemented most of the recommendations of the 1995 monetary and financial statistics mission and further recommended (i) the widening of statistical coverage to microfinance institutions; (ii) the inclusion of the Savings Bank and Postal Administration in the "Other Depository Corporations" subsector; and (iii) the improvement in the timeliness of the BCM's balance sheet.

12. Since August 2001, the BCM is reporting monetary data monetary data to STA by e-mail for publication in *International Financial Statistics (IFS)*. After a brief interruption in data reporting due to the political crisis in 2002, regular data reporting resumed in July 2002. Data for the monetary authorities and deposit money banks through June 2004 have been published in the *IFS*.

13. The 2004 multisector mission assessed the status of the 2001 mission's recommendations and made additional recommendations to improve Madagascar's monetary statistics. Assessing the status of the previous recommendations, it found that several recommendations are pending, such as (i) improvement of the staff and computer resources of the unit in charge of the monetary statistics compilation, (ii) electronic transmission of monthly call report forms by the commercial banks to the BCM, and (iii) expansion of broad money survey to include the microfinance institutions that issue liabilities meeting the national definition of broad money for Madagascar. Furthermore, the 2004 mission recommended improvements to the source data and the compilation of statistical methodology to compile Madagascar's monetary statistics in accordance with the Fund's methodology as described in the *Monetary and Financial Statistics Manuel (MFSM).*

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Madagascar: Core Statistical Indicators
(As of September 27, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/Debt Service
Date of latest observation	04/31/04	8/04	07/31/04	07/31/04	07/31/04	08/31/04	7/2004	Q2/03	Q4/03	9/2003	2003	9/2003
Date received	05/14/04	11/21/03	09/07/04	09/07/04	09/07/04	09/07/04	9/13/04	10/15/03	7/02/04	11/15/03	3/22/04	10/15/03
Frequency of data	M	M	M	M	M	M	M	Q	Q	M	A	A
Frequency of reporting	M	M	M	M	M	M	M	Q	Q	M	V	A
Source of update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting	M	M	M	M	M	M	M	M	M	M	V	V
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C

Notes: Frequency of data: D=daily; M=monthly; Q=Quarterly; A=annual.
Frequency of reporting: W=weekly; M=monthly; Q=quarterly; A=annually; V=irregularly in conjunction with staff visits.
Source of update: A=direct reporting by the Central Bank of Madagascar, Ministry of Finance and Economics, or other official agency.
Mode of reporting: M=mail (including e-mail); V=staff visits.
Confidentiality: C=unrestricted use.

Press Release No. 04/216
FOR IMMEDIATE RELEASE
October 18, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves In Principle Fifth Review Under Madagascar's PRGF Arrangement and Approves US$16.6 million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed in principle the fifth review of Madagascar's performance under an SDR 91.7 million (about US$135.1 million) Poverty Reduction and Growth Facility (PRGF) arrangement. This opens the way for release of a further SDR 11.3 million (about US$16.7 million), bringing total disbursements under the program to SDR 80.3 million (about US$118.4 million). This decision will become effective following the World Bank's review of Madagascar's annual progress report on the Poverty Reduction Strategy Paper, scheduled for October 21, 2004.

In completing the review, the Executive Board waived the nonobservance of four quantitative performance criteria and one structural performance criterion, taking into account the broad-based package of fiscal, monetary, and structural measures implemented since June 2004 to safeguard macroeconomic stability and contain inflation.

The Board further reviewed the annual progress report of Madagascar's Poverty Reduction Strategy Paper (PRSP) and concluded that it provides a sound basis for continued access to Fund concessional financial assistance and for reaching the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative.

A final decision on Madagascar's debt relief under the enhanced HIPC initiative is still pending action this week by the World Bank's Executive Board. A press release will be issued jointly with the World Bank following those deliberations.

Madagascar's three-year arrangement was approved on March 1, 2001 for an initial amount of SDR 79.4 million (about US $117.1 million) (see Press Release No. 01/7) and was extended on December 23, 2002 (see News Brief No. 02/133) until end-November 2004. On March 17, 2004 (see Press Release No. 04/53) the Board further extended the PRGF arrangement until March 1, 2005. and augmented it by SDR 12.2 million (about US$18.0 million).

Following the Executive Board's discussion of Madagascar, Rodrigo de Rato, Managing Director and Chair, stated:

"Madagascar's implementation of the program supported by the IMF's Poverty Reduction and Growth Facility has been broadly satisfactory. The adverse economic impact of exogenous shocks in 2004 was offset by appropriate fiscal and monetary policies. Madagascar's key challenges in the period ahead are to maintain macroeconomic stability, accelerate the implementation of structural reforms, and diversify the export base to boost exports and economic growth.

"The authorities remain committed to achieving their fiscal targets for 2004, while allowing for an increase in cyclone-related capital expenditures. The 2005 fiscal targets should help further to achieve the government's macroeconomic objectives. Vigorous implementation of measures aimed at improving domestic revenue mobilization, particularly at customs, and strengthening expenditure control will be crucial. In this context, the authorities remain committed not to renew the remaining tax exemptions granted in September 2003.

"The monetary program for the rest of 2004 is consistent with the objective of reducing inflation. The expansion of monetary policy instruments, combined with the development of the money market, should facilitate the conduct of monetary policy.

"Maintaining export competitiveness will be crucial to reach Madagascar's development goals and will require prudent macroeconomic policies, improved customs administration, and accelerated structural reforms. Key reforms would include steps to facilitate export diversification and reform public enterprises, including by putting the public electricity and water company under private management. Moreover, the exchange rate should continue to be market determined, following the introduction of a continuous interbank trading system in July 2004.

"The authorities have completed the first annual progress report on the Poverty Reduction Strategy Paper (PRSP) through a broad-based consultation process. The report provides a comprehensive and coherent framework for guiding the implementation of the government's poverty reduction strategy. However, limited capacity continues to jeopardize the government's ambitious reform program. The authorities are committed to seeking donor support for their capacity-building efforts.

"The government has made significant progress in implementing structural and social programs. As a result, Madagascar has reached the completion point under the enhanced HIPC Initiative. After the provision of enhanced HIPC assistance and additional bilateral assistance, Madagascar's debt is expected to fall to sustainable levels. Prudent borrowing, sound macroeconomic and debt management, and progress on structural reforms will provide Madagascar with the basis to maintain debt sustainability following its exit from the HIPC Initiative.

"A final decision on Madagascar's debt relief under the enhanced HIPC Initiative is still pending action this week by the World Bank's Executive Board," Mr. de Rato said.

The PRGF is the IMF's concessional facility for low income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year period on principal payments.

Statement by Damian Ondo Mañe, Executive Director for Republic of Madagascar
October 18, 2004

Despite the severe political crisis of 2002, and a number of severe exogenous shocks, including 1 cyclone in 2002 and 2 cyclones in early 2004, Madagascar has made good progress in the achievement of the objectives set under the program. This progress reflects the strong commitment of the Malagasy authorities to the reform process, their willingness to take quick corrective measures when deviations from the program occurred, and the strong support of the international community for their efforts. This commitment was further strengthened by the government that took office in 2002, and which has been implementing consistently the reform program supported under the PRGF arrangement.

Recent Developments and Performance Under the Program

Developments in 2004 were affected by the hurricanes and a large depreciation of the Malagasy franc. The two hurricanes that hit the island, in early 2004, caused lost of lives, damages to housing, public buildings, infrastructure, and agriculture. Over 300,000 persons were without shelter. The government, with international support, moved quickly to help with the reconstruction efforts. As a result of the hurricanes, there was an increase in imports, mainly of capital goods, as well as a drop in exports, especially of vanilla and shellfish.

These adverse developments in the economy were compounded by the sharp increase in oil and rice import prices, lower than usual repatriation of export proceeds, and larger demand for foreign currency by private imports in response to the tax and tariff exemptions granted in September 2003. All these factors, together with structural weaknesses, and lack of capacity contributed to put pressure on the external accounts, and led to a loss in international reserves, and to the depreciation of the Malagasy Franc. The inflation rate also accelerated. However, in assessing the inflation rate in Madagascar, it is worth noting that if rice and oil prices are excluded, inflation stood at 6 percent in July 2004 (on a year-to-year basis), compared to 17.7 percent for the whole consumption basket.

The above developments were responsible to a large extent for the missed performance criteria. However, the authorities took remedial actions and implemented a number of measures in both the fiscal and monetary sectors, as described below, to ensure that the program remains on track.

In the fiscal area, fiscal targets were broadly in line with the program in the first six months of 2004, except for tax revenue which was 0.03 percent of GDP below the end-March performance criterion, and 0.1 percent of GDP below the end-June indicative targets. These shortfalls reflect, among others, the impact of the cyclones, and the tax exemptions given in September 2003. The government, however, was able to contain outlays on non-priority expenditure. It also resisted demands for wage increases in the public sector, despite the higher inflation, and a 16 percent increase in the private sector minimum wage. The authorities implemented a number of strong corrective actions in July, which included,

- tightening eligibility to customs duties advances, and reducing its length to one month;
- repealing tax exemptions on non-capital goods;
- intensifying the fight against fraud at tax and customs departments;
- accelerating customs procedures;
- regular rotation of customs agents; and
- establishment of performance contracts for customs agents.

Following the introduction of these measures, the revenue performance has improved significantly, with the original July and August forecasts exceeded. My authorities are confident that the end-September and end-of-the-year revenue targets will be met.

In the monetary and exchange sectors, developments in the foreign exchange market and the inflation front posed serious challenges to the authorities. In response, the central bank

- increased the reserve requirements on demand deposits from 12 to 15 percent, reduced banks' maximum net open foreign exchange positions from 20 to 10 percent, and broadened the reserve requirements base;
- conducted a reverse auction in August and September, and raised its the base rate from 7 to 16 percent in three steps;
- discontinued the purchase of treasury bills from banks in July; and
- introduced a new electronic and continuous inter-bank foreign exchange market system in July. The system has contributed to improve the efficiency of the foreign exchange market

As a result, interest rate rose and excess liquidity decreased sharply. Furthermore, the Malagasy franc has stabilized, and the rate of increase of inflation has slowed down.

In the structural area, the performance criterion on the sale of the cotton company, HASYMA, was missed due to the fact that, although five companies expressed interest, only one bid was received, but it had to be rejected as it did not comply with the terms and conditions of the sale. However, on October 7, 2004 the privatization of the company was completed**.** The structural benchmark on the replacement of the existing system of exchange rate determination by a continuous interbank trading system was missed because some of the commercial banks were not technically ready to start using the new electronic system. It was completed in July. The end-June performance criterion regarding the sugar company SIRAMA has been met, the petroleum prices have been fully liberalized, and the telecommunications company TELMA has been privatized. The public transportation sector was also liberalized, although not a condition of the program.

Other reforms that have been implemented are:

- the promulgation of a new legislative framework for public finance;

- the recommendations of an independent audit of the Treasury and the strengthening of the treasury accounting system;
- the overhaul of the procurement system with the introduction of a new Procurement Code;
- a fully functioning independent anti-corruption agency has been set up; and
- work is continuing on the strengthening of the judicial system.

In view of the measures taken, the program is now fully on track. My Malagasy authorities would like, therefore, to request waivers for the missed performance and structural criteria. My authorities would also like to point out that at end-June 2004, all quantitative indicative targets were met, except for those pertaining to net foreign assets and tax revenue. Measures that have been taken will ensure that the end-of-the-year targets in those two areas will be fully met.

In spite of the shocks felt, it is worth noting that economic and financial performance has been encouraging, indicating that the reforms that have been undertaken are bearing fruits, and that the economy is gaining resiliency. In this regard, real GDP is expected to grow by a healthy 5.3 percent in 2004, on the basis of strong activities in the tourism sector, export processing zones and construction sector. Good progress is also being made in the implementation of the poverty reduction strategy.

Program for the remainder of 2004 and 2005

My Malagasy authorities remain fully committed to the reform process and to the objectives of the program. As noted above, they have taken strong steps to strengthen the program, and are confident that the program targets will be met. Policies for the remainder of the year will be focused on safeguarding macroeconomic stability, limiting the second round effects of the rising inflation, meeting the revenue target, reducing volatility on the foreign exchange market, and securing a gradual build-up in official reserves. In terms of quantitative objectives, the program expects to achieve real growth rate of 5.3 percent in 2004, and 7 percent in 2005. The annual average inflation rate is expected to be contained at 10.1 percent in 2004, and reduced to around 7 percent in 2005. The level of international reserves is also projected to increase to an equivalent of about 3 months of imports by year-end.

In the fiscal sector, measures already implemented should help tax revenue to reach the target of 11.2 percent of GDP. Non-interest expenditure is projected to be reduced. However, interest charges will increase, together with domestically financed capital expenditures, which would cause a slight increase in domestic balance. For 2005, tax revenue is expected to grow to 11.8 percent of GDP, reflecting the full year effect of the strengthening of the tax and customs administrations, as well as the repeal of the tax exemptions. On the expenditure side, wage policy will remain prudent, and capital expenditure will decline due to the phasing-out of domestically financed capital expenditures related to the cyclones. As a result, domestic balance is projected to show an improvement, equivalent to 1 percent of GDP.

Building on the successful measures already implemented, monetary policy will continue to focus on containing inflation and excess exchange rate volatility. At the same time, the central bank will continue its policy of strengthening liquidity management, and ensuring consistency in the use of monetary policy instruments. In this regard, a number of recommendations made by the MFD mission are being implemented, and regular meetings are now held between officials from the Ministry of Finance and the central bank to assess and update the Treasury financing needs. These measures are helping to better coordinate actions by the Central Bank and the Ministry of Finance regarding the purchase and sale of Tbills. The central bank is also implementing the recommendations regarding the safeguards assessment report.

In the external sector, the main concerns remain the increase in the international prices of petroleum products and rice, and the fall in the export price of vanilla. These developments could worsen the balance of payments. However, the authorities are hopeful that the gains in competitiveness will help the tourism sector and the export processing zone, thus helping to mitigate those increases. The authorities are also pursuing their efforts to encourage external trade, and economic diversification. In this regard, the tariff structure has been simplified, and the top rate has been reduced to 25 percent. Moreover, work is ongoing to ensure Madagascar’s full integration into the economic zone of the SADC.

In the structural area, the authorities will pursue the reforms already started. In particular, a number of reforms are envisaged in the fiscal area to strengthen budgetary operation, and to align the budget closer to the PRSP priorities. Strong measures have also been taken to strengthen customs administration. Additional measures will be implemented in 2005, and include the reassessment of previously granted ad hoc customs exemptions, the mandatory payments of customs duties through the banking system, and the prosecution of custom agents who commit fraud. Port procedures and customs operations are being reformed, and the procedures for approval of foreign investment are being streamlined through the creation of a one-stop window. The regulations on subcontracting of EPZ operations to small firms are also being simplified. The program of privatization will be pursued according to the plan of action, and efforts will continue as regards the strengthening of governance.

PRSP Progress Report

Madagascar is making good progress in the implementation of its poverty reduction strategy. The participatory process and ownership remain high. Workshops were held early this year involving a wide range of stakeholders to receive feedbacks and assess implementation. The workshops indicated that progress was being achieved in many areas, and they also identified weaknesses which are being addressed.

The progress achieved can be seen in the primary schools where over 3,400 teachers have been recruited since 2001, with 89 percent being deployed in rural areas. The enrolment rates in primary schools have increased from about 70 percent in 2002 to 84 percent in the school year 2003/04. In the health area, surveys show a continuing downward trend in child and infant mortality rates, and improved immunization rates. Progress is also evident in the area of nutrition, which is benefiting from initiatives undertaken with donor participation. Efforts are also ongoing to improve the performance of existing hospitals prior to further expansion of the hospital network. As regards infrastructure improvement, the Government has complied with the condition calling for 100 percent of current road maintenance needs being covered through the Road Maintenance Fund. HIPC resources have been used to maintain 6,000 km of road, rehabilitate 1,670 km of rural roads and 180 km of paved roads. This has also created employment for about 12,000 workers, and contributed much to the alleviation of poverty in rural areas. However, not much progress has been achieved in the reduction of overall poverty, as efforts were nullified by the recent hurricanes. Reforms in many sectors, including governance, the simplification of many regulations, and the new Property Act of August 2003, which allow foreign investors to own land are expected to help diversify the economy and have a positive impact on poverty.

My authorities have taken good note of the assessment of the staff of the Fund and the World Bank as well as the views of stakeholders during the workshops. Based on these recommendations, the authorities will take the necessary measures to improve the implementation of the PRSP.

Completion Point Under the HIPC Initiative

In spite of the political crisis, and the exogenous shocks that have affected Madagascar since the decision point, the authorities have maintained their commitment to the reform process, and have implemented with determination the measures and policies envisaged under the program of adjustment. As a result good progress has been achieved towards macroeconomic stability, and in the implementation of a wide range of structural reforms. The growth rate has strengthened, and progress is being made to improve the quality of life. Madagascar has also broadly met the completion point triggers, prepared a full participatory PRSP in July 2003, and released the Fist Annual Progress Report on the implementation of the PRSP. Moreover, budgetary savings from interim debt service relief have been used in line with the criteria set forth at the decision point, and have been used to support improved service delivery in primary education, health, and rural infrastructure. The government with donor assistance has also improved its ability to use public resources effectively, through enhancement of the poverty reducing expenditure tracking mechanisms, and in the monitoring system, as well as improving governance.

As regards debt sustainability, the revised calculations, after taking into consideration full implementation of traditional debt relief mechanisms, show a slight increase of the NPV of debt from the calculations made at the decision point. However, additional debt relief received from bilateral creditors, has enabled the NPV of debt-to-exports ratio to be brought to 137 percent. While we are appreciative to the creditors who have provided the additional relief, we note that had this not been the case, the debt ratio would have been much higher than the HIPC threshold. We are, therefore, of the view that, under the principle of equal treatment for all creditors, Madagascar should have been provided with additional debt relief. In view of the vulnerabilities to exogenous shocks and the difficult financial position of the country, we hope that other creditors will follow the example of those that have already provided additional relief, so that Madagascar can quickly reach a fully sustainable external position, that enables the country to allocate resources to poverty reduction and economic development that can enable the country to reach the MDGs.

In conclusion, in view of the fact that Madagascar has satisfied broadly the conditions for reaching the completion point, the assurances received from creditors, the progress achieved under the program, and the strong commitment of the authorities to pursue the adjustments process, I would appreciate Directors' support for the proposed decisions.