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GRAY/20/3085

October 1, 2020

**Statement by Ms. Shortino and Ms. Senich on Malawi
(Preliminary)
Executive Board Meeting 20/99
October 2, 2020**

We thank staff for the reports and Messrs. Mahlinza and Sitima-wina for their helpful Buff statement. While we regret that the authorities have decided to cancel the Extended Credit Facility, we recognize that Malawi faces a major adverse shock that has arisen from the pandemic and we support the second request for disbursement under the Rapid Credit Facility for approximately \$100 million, 52.1 percent of quota.

We are, however, troubled by the new administration's shift away from a conditional program to an RCF. We question the need for the ECF cancellation, as the remaining program structural reforms seem to align with the priorities under the authorities' reform plan. *Could staff comment on whether there were discussions on keeping the program and adjusting the program targets to reflect the impact of COVID?* We view an ECF as an appropriate tool to help guide long-term structural reform programs to improve Malawi's shock-absorption capabilities and to make the necessary policy changes to support the country's recovery moving forward. *Could staff elaborate on the authorities' timeline for finalizing a new reform strategy and transitioning to a new ECF?*

We support a fiscal expansion to accommodate the deteriorated economic outlook but caution that additional spending should be used for temporary measures to respond to the crisis. We agree with staff's assessment that the doubling of the personal income tax threshold and the recent increase in the public sector wage bill are not the best use of increase fiscal space, and encourage the authorities to make these measures temporary and to clearly communicate the timeline for removing them. Returning to fiscal consolidation over the medium term will be important to return debt to a sustainable path. We therefore welcome

the authorities' intentions to improve non-tax revenue collection and completing the Integrated Tax Administration System. We also welcome the authorities' request for debt servicing relief from bilateral creditors under the G20 DSSI.

The updated Debt Sustainability Analysis substantiates that the Agricultural Input Program (AIP) will increase domestic spending further and heighten risks to debt sustainability compared to the April 2020 DSA. We are cognizant of the importance of supporting poor and rural populations during this economic downturn, but are concerned that the AIP will not be an effective tool to achieve that goal. Specifically, we would note that subsidies could potentially create market distortions, which may result in low or negative economic yields, and encourage unsustainable and/or inefficient farming practices. Malawi's agricultural sector has not performed as projected despite receiving substantial funds from the Government of Malawi and development partners. It will be important to ensure that the AIP is right-sized for Malawi's needs.

Malawi's exchange rate has come under pressure in recent months due to COVID. While greater exchange rate flexibility is important for long-term macroeconomic stability, we acknowledge that near-term downside risks may arise if the exchange rate depreciates substantially. We note from the Buff statement that the Reserve Bank of Malawi (RBM) remains committed to implementing greater exchange rate flexibility to absorb shocks, and welcome Fund engagement with the RBM in FX market development. *Could staff please provide a status update on progress of study on FX market development, previously anticipated for June 2020?* Further, Malawi's engagement with other development partners is encouraging. The program document notes that should these engagements fall through or if the financing gap widens, reserves would be drawn down to 3.1 months of imports, below the adequate level of 3.6. We encourage the authorities to continue to engage with development partners to preserve macroeconomic stability as their long-term economic plan continues to evolve.

Finally, we commend the GOM's efforts in strengthening government transparency through the publication of consolidated annual financial statements and monthly bank reconciliation reports, as well as the monitoring of the AIP's implementation, and look forward to seeing further progress on transparency benchmarks in the coming months.