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December 9, 2021

**Statement by Ms. Rieck and Mr. Weissermel on Malawi  
(Preliminary)  
Executive Board Meeting  
December 13, 2021**

We thank staff for the informative report and concur with the overall assessment and thank Ms. Mannathoko and Ms. Nainda for their helpful buff statement. We are particularly concerned about the dire fiscal and external situation described in the report. Without immediate and decisive action to restore debt sustainability and build up external buffers, downward risks to Malawi’s economy are likely to materialize and prospects for macroeconomic stability and sustainable growth will worsen further. Therefore, as staff, we see a need for fiscal adjustment, meaningful and appropriate debt treatment where necessary, a more flexible exchange rate and more elaborated monetary instruments.

**We urge the authorities to tackle the weaknesses in their governance frameworks.** This includes the continued efforts to combat corruption in government bodies and to improve public procurement and audit functions as well as to implement the recommendations of the last safeguard assessment to foster central bank independence and its integrity. We strongly encourage efforts to shed light on the “potential noncomplying disbursements under the 2018 Extended Credit Facility (ECF)” as stated in the staff report. In this context Germany supports the government of Malawi by financing a “special audit of foreign exchange reserves.” Also, the completion of COVID-19 spending audit reports is necessary to draw a clear picture of suspected irregularities regarding COVID-19 related public funds. *We would appreciate if staff could share latest information on the progress of addressing these governance issues and necessary follow-up actions.*

**Malawi’s rapid increase in risks to external debt sustainability (from “moderate” at the time of the RCF request to “high/unsustainable under current policies”)** as well as the

**deterioration in the capacity to repay the Fund (from “strong” at the time of the RCF request to a disconcerting “weak” in this report) are alarming.** At the time of the RCF request overall debt service was projected to be roughly 110 million USD in 2022 (increasing over time to more than 215 million USD per year). Now, projected annual debt service stands at 528 million USD in 2022 (increasing steadily to over 1 billion USD over time). These huge revisions and the marked increase in risks over a short period could raise questions on the firmness of the authorities’ commitment and ability to follow prudent policies.

*Concerning the considerable change in the staff’s assessment between the RCF request and this Article IV consultation, we would welcome staff comments, including lessons learned from this case.*

**We urge the authorities to reduce sizeable fiscal imbalances, develop and implement a revenue mobilization strategy and to better prioritize expenditures.** We welcome that Malawi has launched its Domestic Resource Mobilization Strategy and look forward to its implementation. We also want to highlight the importance of realistic fiscal forecasting without being too optimistic, particularly given the fragile environment.

**The authorities should take actions to reduce the current account deficit and build up external reserves.** The depleted official reserves make Malawi very susceptible to external shocks. Therefore, it seems needed to move to a market-clearing rate to reduce the excessive external deficit and to enable the authorities to rebuild reserves. We note that allowing greater exchange rate flexibility to correct the large overvaluation of the REER will likely put additional pressure on inflation, especially without appropriate central bank action and fiscal consolidation. Consequently, reserve money growth needs to be contained and open market instruments should be further developed to better manage liquidity. *How does staff evaluate the availability of necessary instruments to mop up excess liquidity in case of a conversion to a market-clearing exchange rate?* As we understand, the pass-through of policy rate adjustments is limited by the shallow banking system. Developing the interbank market, deepening the domestic securities market and seeking technical assistance would improve monetary policy transmission and the efficiency of the financial system. The RBM needs a strong mandate to contain inflation and the government’s refinancing costs should not influence monetary policy.

**Before a potential ECF arrangement, adequate capacity to repay the Fund needs to be restored and we would expect strong policies by the authorities to improve public finances as well as sufficient assurances or, where necessary, adequate debt treatment by creditors (especially those currently providing non-concessional debt despite an unsustainable debt trajectory) to ensure that debt is firmly back on a path to sustainable levels.** We would welcome the Regional Development Banks to assess how they

could further support a sustainable path of Malawi's finances, e. g. by extending concessional financing. As stated before, the case of misreporting official reserves needs to be resolved and the audit of COVID-19 related spending fully realized before additional financing can be made available by the Fund.