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EBS/84/32

CONFIDENTIAL

February 29, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Malawi - Review Under Extended Arrangement

Attached for consideration by the Executive Directors is a paper on a review under the extended arrangement for Malawi. A draft decision appears on pages 31 and 32.

It is proposed to bring this subject to the agenda for discussion on Monday, March 26, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Edo (ext. (5)8750) or Mr. Bell (ext. (5)8755).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

MALAWI

Review Under Extended Arrangement

Prepared by the African and Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by J.B. Zulu and S. Kanesa-Thasan

February 28, 1984

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I. Introduction

A staff team visited Malawi during the period November 30-December 14, 1983 to review performance during the first year of the three-year extended arrangement for SDR 100 million (268.8 percent of quota) 1/ approved by the Executive Board on September 19, 1983 (EBS/83/183 and Supplement).2/ The Malawian representatives in the discussions included the Minister of Finance, the Governor of the Reserve Bank, the Secretary to the Treasury, and other senior officials.

Malawi has purchased SDR 10 million: SDR 5 million on Board approval and SDR 5 million on the satisfactory observance of the performance criteria for end-September 1983. As the quantitative ceilings for December 1983 have been observed, a further SDR 5 million may be purchased on completion of the present review. The Fund's holdings of Malawi kwacha subject to repurchase at December 31, 1983 amounted to SDR 97.8 million (262.9 percent of quota); excluding purchases under the compensatory financing and buffer stock financing facilities, the holdings subject to repurchase were SDR 74.9 million (201.3 percent of quota). If all purchases are made, the Fund's holdings of Malawi's currency subject to repurchase (excluding special facilities) will amount to 314.9 percent of quota by the end of the arrangement (September 1986).

This review is required under the arrangement to reach understandings on the performance criteria for domestic bank credit to Government and net domestic assets for March 1984, limits on the contracting or guarantee by the Government of new nonconcessional external borrowing during 1984, and measures to achieve the objectives of the program, including the appropriateness of the exchange rate, the structure of interest rates, the framework for the 1984/85 budget, and the steps necessary to continue the process of price liberalization. In response to comments made during the Board discussion of the extended arrangement, the mission undertook a comprehensive examination of the parastatal sector and the possible sources of savings generation, and this paper consequently contains more detailed information than would normally be presented in a review paper.

In the attached letter to the Managing Director dated February 28, 1984, the Minister of Finance and the Governor of the Reserve Bank reaffirm the intention of the authorities to pursue the policies in support of which the extended arrangement was approved, and describe the measures that the authorities will take to ensure that the targets for the first year

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1/ Malawi's quota under the eighth review, amounting to SDR 37.2 million, became effective on December 7, 1983.

2/ The staff team on the December mission consisted of Messrs. M. Edo (head-AFR), M. Bell (AFR), A. Abisourour (ETR), D. McDonald (FAD), and Mrs. B. Nairn (secretary-AFR); Mr. S. Kanesa-Thasan (ETR) participated in some of the discussions. In January Mr. Gunjal (AFR) and Mr. Abisourour (ETR) visited Malawi for a few days to obtain updated information on the the budget.

of the arrangement will be observed. The letter also proposes the quantitative ceilings for end-March 1984 and states that the budget for FY 1984/85 (April-March) will be in accordance with the framework established at the beginning of the program period.

On December 20, 1983 the World Bank approved a second structural adjustment loan (SAL II) for Malawi in the amount of US$55 million.

II. Recent Developments and Performance Under the Extended Arrangement

1. Production, expenditure, and prices

Following two years of stagnation in 1980 and 1981, real GDP grew by 3.0 percent in 1982 and is estimated to have risen by 3.1 percent in 1983 (Appendix Table I). This is slightly higher than the program forecast, and the growth performance reflects the expansion of total agricultural production, although individual crops have shown different growth patterns. Real agricultural output rose by 3.5 percent in 1983. In contrast to several other southern African countries, climatic conditions in Malawi improved sufficiently to allow a very good tobacco crop and a modest increase in total maize production: the marketed production of tobacco (Malawi's main export crop) was about 23 percent higher than in 1982, while the estimated total maize crop rose by 5 percent.1/ However, the rainfall was not adequate to prevent a decline in some other crops: the production of tea and sugar (both important export crops) declined by about 3 percent and 5 percent, respectively. Other crops grown for domestic markets also fell: rice by 2 percent, pulses by 14 percent, and cotton by 13 percent.

Although tobacco production rose significantly, auction prices were sharply lower; the average realized price in 1983 was 27.5 percent lower than 1982. Thus the nominal value of tobacco sales was about 10.5 percent lower than the previous year, and many enterprises in the tobacco sector experienced further deterioration in their financial performance as a result. Although sugar production fell only slightly, export sales, which accounted for 75 percent of production in 1982, virtually ceased in 1983 because continued disruption of Malawi's external trade routes combined with low world prices made export sales uneconomic. This enforced stockbuilding placed a considerable additional financial burden on the agricultural sector.

In other sectors preliminary estimates show that real economic activity also rose, partially reversing the declines in recent years (Appendix Table I) and absorbing spare industrial capacity. In the first

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1/ Since most maize is produced by households in the subsistence sector, only a small proportion of the total enters the monetary sector. Marketed production is estimated to have risen by about 5-6 percent in 1983 following an 80 percent increase in 1982.

seven months of 1983 manufacturing output rose by 13.5 percent over the corresponding period in 1982; electricity sales rose by 10.5 percent in the first nine months, and a similar increase was recorded in water distribution. The increased volume of marketed agricultural production is believed to have led to a significant rise in the value added of the distribution and transportation sectors, more than offsetting the negative impact of the external transportation difficulties. However, the relatively low level of total investment, and a shift away from infrastructural investment, has resulted in continuing stagnation in the construction industry.

The decline observed between 1978 and 1982 in the ratio of investment to GDP was halted in 1983 (Appendix Table II and Table 1), and the estimated increase in the nominal value of fixed capital formation of 17.6 percent represents a rise of about 9.0 percent in real terms. The substantial absorption of resources in stockbuilding during 1982 and 1983 reflects the accumulation of sugar and other goods awaiting export. Domestic saving remained almost unchanged when expressed as a percentage of GDP, the relative increase in total investment expenditure being financed by a larger reduction in foreign reserves than anticipated and by the positive impact on net foreign capital inflows of the first full year of debt relief in 1983.

Price developments during 1983 were affected by higher import prices following the devaluation of the Malawi kwacha in April 1982 and by the substantially higher external transport costs that Malawi incurred after September 1982, caused by the need to reroute its external trade to longer road/rail routes to South African ports. Tentative estimates suggest that the increase in transport costs may have added at least 5 percentage points to the annual rate of increase of domestic retail prices in the 12 months from September 1982. However, a major part of the inflationary pressures observed in this period (Chart 1) had been absorbed by the system by October 1983. These developments have resulted in a revision to the estimate of consumer price inflation in 1983 to 15.4 percent, or 2 percentage points higher than anticipated, although the preliminary indications are that the rate is returning to the underlying rate envisaged in the program of about 10 percent by end-1983. Two further developments in 1983--the 12 percent devaluation and the liberalization of price control initiated during the year--are likely to militate against any immediate further deceleration in domestic prices. In contrast to the indices of consumer prices, the rate of increase of the GDP deflator decelerated significantly in 1983 (Appendix Table I), a consequence of the sharp fall in export unit values, which fell by about 13 percent, largely because of a 25 percent decline in tobacco export unit values.

In September 1983 agricultural producer prices for the 1983/84 growing season were increased in the range of 9-10 percent, except for rice, where prices were increased by 30 percent. This will continue the improvement in agricultural incentives commenced in 1982 and 1983,

Table 1. Malawi: Investment and Saving, 1979-86

(In millions of Malawi kwacha at current prices)

	1979	1980	1981	1982 1/	1983 Orig. proj.	1983 Est.	1984	1985	1986
							Projections		
Gross fixed investment	240.1	259.6	212.2	216.9	244.0	255.0	299.1	365.7	439.2
Change in stocks	61.6	-0.4	34.1	73.2	57.4	89.4	45.1	48.7	52.3
Total investment	301.7	259.2	246.3	290.1	301.4	344.4	344.3	414.5	491.4
Domestic saving	131.1	114.7	156.0	204.1	211.8	226.5	250.5	331.1	399.1
Net factor income from abroad	-34.8	-42.3	-47.5	-31.5	-38.1	-33.7	-39.7	-36.0	-33.1
National saving	96.3	72.4	108.5	172.6	173.7	192.8	210.8	295.1	366.0
Transfers from abroad (net)	37.8	35.4	40.1	38.3	40.0	45.2	51.0	55.8	66.0
Foreign capital flows (net)	96.4	158.0	62.8	32.5	69.6	66.4	69.5	54.6	61.6
Change in foreign reserves	71.2	-6.6	34.9	46.7	17.8	40.0	13.0	9.0	-2.2
Total saving	301.7	259.2	246.3	290.1	301.4	344.4	344.4	414.5	491.4
Sources of domestic saving:									
Government	10.4	13.9	-31.8	-31.3	...	-15.7	-3.3	20.2	36.1
Statutory bodies	1.4	3.0	17.4	11.6	...	13.0	18.1	23.0	28.4
Other sectors	119.3	97.8	170.4	223.8	...	229.2	235.7	287.9	334.8
Memorandum items:					(Percentages)				
Fixed investment/GDP	27.3	25.7	18.2	15.3	15.4	16.0	16.6	18.1	19.4
Total investment/GDP	34.3	25.6	21.2	20.5	19.0	21.6	19.1	20.5	21.7
Domestic saving/GDP	14.9	11.3	13.4	14.4	13.3	14.2	13.9	16.4	17.6
National saving/GDP	10.9	7.2	9.3	12.2	10.9	12.1	11.7	14.6	16.2
Other sectors' saving as a percentage of:									
GDP	13.6	9.7	14.7	15.8	...	14.4	13.1	14.2	14.8
Domestic saving	91.0	85.3	109.2	109.7	101.2	...	94.1	87.0	83.8

Sources: Economic Reports 1982 and 1983; data provided by the Malawian authorities; and staff estimates

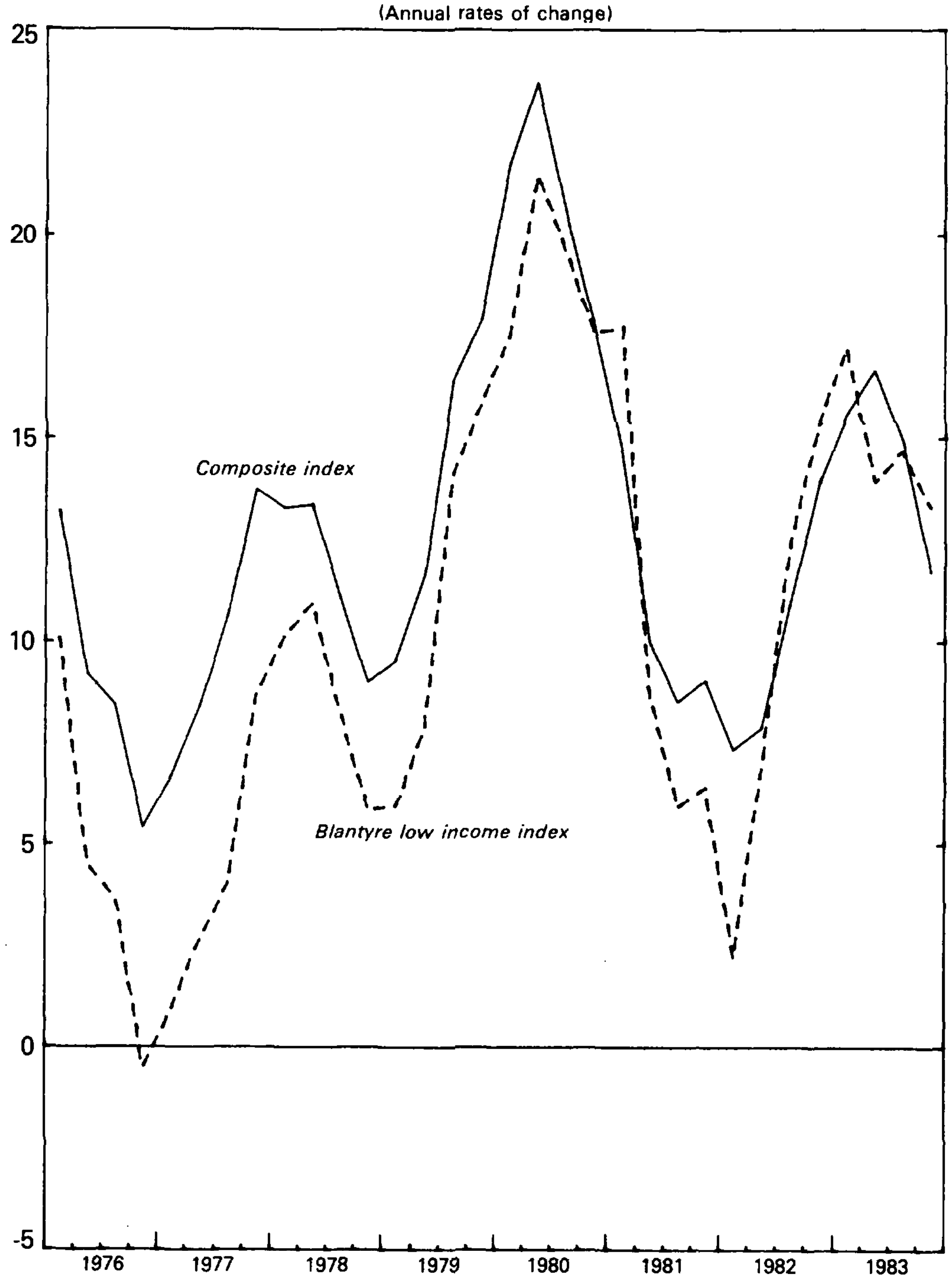
1/ Revised estimate.

CHART 1

MALAWI

RETAIL PRICE INFLATION, 1976-83

(Annual rates of change)



Sources: Data provided by the Malawi authorities; and staff estimates.

which reversed a downward trend in agricultural returns.1/ Agricultural production has shown considerable sensitivity to recent price rises:

Malawi's present exportable surplus of maize follows a 67 percent price increase in 1981/82 that made most other crops relatively less attractive. Although the maize price was increased in September 1983, it is estimated that the differentials in returns among crops will narrow during 1984, thus helping to restore production of several crops to former levels.

2. Transportation

The transportation of Malawi's external trade continues to be a major problem, with implications for many aspects of economic activity. The interruption of the Beira rail route by insurgent activity and the poor state of the Nacala line have resulted in serious shortages of a range of imported commodities, especially petroleum products and fertilizers. Substantial stocks of tobacco, tea, and sugar destined for export in 1982 were still in the country in early 1983. Another consequence was the stockpiling of 66,000 tons of imported fertilizer in the port of Beira, necessitating the procurement of duplicate supplies, at higher costs. Imports of almost all other essential materials and products, including petroleum, were similarly affected.

The growing seriousness of the transportation crisis since August 1982 and the realization that the basic causes for this crisis are likely to continue for the rest of the decade led the Malawian Government to form a special task force, the National Transport Committee, with a full-time secretariat to monitor and coordinate international trade flows. The committee arranged emergency procurements for fertilizers and petroleum fuels and began planning for the development of alternative routes and services that would be sufficiently flexible to cope with changing conditions over the next 5-10 years. The stated objectives are: (a) to obtain maximum utilization from the Mozambican rail routes, particularly the Nacala line, which is free of insurgent activity; (b) to reorganize and strengthen Malawi's indigenous international road transport capacity for use as a reliable and less costly alternative; and (c) to develop an alternative route through northern Malawi to Dar es Salaam in Tanzania.

Discussions are being held with potential sources of external financial aid and technical assistance for the purpose of achieving the stated transportation objectives. In the meantime, economic performance will continue to be affected by developments in the transport sector, and future growth will depend on the success of the efforts to improve and diversify external transportation routes.

1/ The incentives are measured by real gross margins per labor day for each crop.

3. Statutory bodies and Press Holdings

Until the late 1970s the parastatal sector was financially strong, capable of generating domestic savings and contributing to investment. From 1979 its performance deteriorated under the influence of adverse economic conditions, poor management, decision-making that at times was based on noncommercial considerations, and the extensive informal system of price control. Under previous programs with the Fund and the World Bank steps were initiated to study and rectify the problems of several important statutory bodies, in particular: the Agricultural Development and Marketing Corporation (ADMARC), Malawi Railways (MR), and the Malawi Development Corporation (MDC). Many of the problems are specific to the individual enterprises, but the intention in each case has been to restore operations to a purely commercial basis, to establish well-formulated investment plans, to restrain operating costs, to improve the quality of management, and to ensure that appropriate pricing and tariff policies are pursued without undue external control. Under the World Bank's SAL II operation a number of additional measures have been adopted during 1983.

ADMARC's performance improved significantly during the year, in spite of very weak prices for tobacco that reduced its gross margins in tobacco trading (ADMARC buys from smallholders at guaranteed prices and then sells at free market prices on the auction floors). The main cause of the improvement has been the large export sales of maize negotiated during 1983; it is expected that a total of 200,000 metric tons will have been sold to neighboring countries in the year ending March 31, 1984.1/ This exportable surplus is a consequence of record purchases made during 1982 and 1983 (following the 67 percent increase in maize prices in 1981/82), which have allowed the accumulation of strategic maize stocks up to the maximum storage capacity. Among other measures taken by ADMARC are: the appointment of a new board of directors, the creation of a post of general manager, and appointments of appropriately qualified persons to key management positions, including financial controller. It has also undertaken a rationalization of its investment portfolio, as part of the Press restructuring (described below), in order to concentrate its activities in the agricultural sector. During 1983/84 ADMARC is now expected to show a net profit of MK 5.1 million compared with MK 3.0 million in the previous year, and to turn the 1982/83 cash flow deficit of MK 9.3 million to a surplus of MK 2.0 million. A program and timetable of actions has been established under the World Bank SAL II program to continue ADMARC's rehabilitation. This includes reductions in marketing costs by reducing the number of outlets; improving pricing policies by better analysis and planning; limiting new investments to marketing or processing activities; and improving the quality of management throughout the corporation. ADMARC's financial position appears to be sustainable in the immediate future, but its medium-term outlook depends on some

1/ The average sales price on the first 130,000 metric tons was US$160 per tonne.

factors beyond its control--climatic conditions and auction floor prices for its principal sales commodities.

The Malawi Development Corporation (MDC) has undertaken a substantial reduction in its staff and has ceased operating a number of loss-making subsidiaries. Management has been strengthened by the recruitment of a new general manager. MDC's investment objectives have been redefined so as to provide a more balanced portfolio, excluding property and tourism, and reducing exposure to individual projects in both relative and absolute terms. The disposal of some assets is a further option being considered, although the authorities feel that the market is not strong at present. The company's financial position in the period 1984-85 will be seriously affected by its external debt service liabilities. Although the foreign debts were rescheduled as part of the general rescheduling, MDC is required to continue servicing the domestic currency equivalent unless the Government decides to allow the debt relief to be taken by the company. MDC's management believes that the liberalization of price control will have a positive impact on its subsidiaries' financial performance, thus allowing it to earn a higher dividend income. Nevertheless, the company will not be able to operate with a manageable cash flow unless debt relief or refinancing is obtained.

Malawi Railways' (MR) financial position has been seriously weakened by the disruption to the rail routes through Mozambique: the volume of revenue earning goods traffic was 45 percent lower in the six months March-September 1983 than the same period in 1982, the result of a 56 percent decline in international traffic. In order to meet the estimated cash shortfall of MK 3.2 million in 1983/84 created by this problem, MR has undertaken a program of reducing operating costs and overheads, including a 15 percent reduction in staff to be implemented in the period up to March 1985, of which an initial 5 percent has already been implemented. A 15 percent tariff increase was introduced in September 1983, but, although MR will benefit from higher revenue earned on its own segment of the rail connection to the Indian Ocean ports, a larger foreign exchange payment to Mozambique will arise for the use of that country's portion of the rail lines. MR will also implement a track rehabilitation program over the next five years, supported by foreign financial and technical assistance. However, the sections of track most in need of repair are in Mozambique, many in a seriously delapidated state.

The Malawi Housing Corporation (MHC) has also undertaken a number of measures to improve its performance. A 20 percent increase in its rent structure will take effect in April 1984. More fundamentally, MHC is changing its emphasis away from the direct ownership and management of housing estates and toward developing estates for sale to the private sector--corporations and individual households. The World Bank is in the process of appraising a housing project designed to enhance the role of the private sector in housing. Tariff increases were also implemented in early 1983 for both the Electricity Supply Company of Malawi (ESCOM) and the Blantyre Water Board (BWB), and further increases are being considered for January 1984. Both of these statutory bodies are in a period of relatively low investment activity, but both expect to undertake major new projects in 1985 and 1986. In order to meet the finance charges arising from previous development and generate resources for these new projects, the authorities recognize the need to maintain profitability and to adjust tariffs regularly. Moreover, ESCOM has reduced its workforce between 1981 and 1983, as its earlier investments were completed. In these cases, as in the rest of the parastatal sector, the authorities intend to review tariffs during the annual budgeting exercise. Among the statutory bodies, the one currently least able to plan future operations is Air Malawi, due to the change in traffic patterns caused by the opening of the new international airport at Lilongwe and financial difficulties due in part to its aging fleet of aircraft. A major market study is to be undertaken to forecast demand for its services and so to determine the appropriate direction for future development.

The task of monitoring the operation of the parastatal sector is the responsibility of the Department of Statutory Bodies (DSB). The existence of this agency has enabled the authorities to maintain regular and closer supervision of the parastatals to identify problems common to many enterprises and to improve the coordination and consistency of their policy decisions affecting the sector. More recently the authorities have taken steps to ensure that the DSB does not duplicate the function of other departments, leaving decisions specific to a statutory body to the parent ministry.

A legal agreement was signed on December 14, 1983 1/ reconstituting the Press group and its financial obligations broadly along the lines contained in EBS/83/183 (pages 16-18). The parties to this agreement were those institutions directly affected: the Government, the two commercial banks and ADMARC, together with Press Trust (the ultimate owner of the group), and Press (Holdings), Ltd. (PHL), the former holding company. Under the new arrangements Press Group, Ltd. (PGL) has taken over all PHL's assets and liabilities and will be the vehicle for paying dividends, servicing debt, and making payments to Press Trust. For operational purposes, the new holding company is Press Companies, Ltd. (PCL), wholly owned by PGL, to which PCL has issued equity and income notes. The group's substantial agricultural interests have been consolidated under a new subsidiary (PAL), while its minority interests, mainly in industry and commerce, are to be held by an investment trust (PITH), with a view to the eventual sale of these assets to domestic or foreign investors. The Government has assumed responsibility for some educational and health facilities previously financed by Press Trust; for all other social projects financed by Press Trust, a ceiling of MK 1 million has been imposed on the annual amount which can be paid to Press Trust during the first five years, after which the amount will be reviewed. At the effective date of the agreement (July 1, 1983) PHL's liabilities amounted to

1/ The effective date for the valuation, the restructuring, and the commencement of associated financial flows is July 1, 1983.

MK 127.4 million, of which those to its principal creditors were: ADMARC (MK 54.4 million), the two commercial banks (MK 54.2 million), and the Government (MK 16.4 million). PHL's liabilities to ADMARC have been reduced to MK 40.4 million by transferring to ADMARC the ownership of some of Press's former subsidiaries in farming or agriculture-based industry (e.g., tobacco processing, sugar growing and refining, grain milling, and textiles). The remaining liabilities have been converted to income notes with a coupon rate of 10 percent and maturity of 25 years, or less if Press's financial position were to improve sufficiently. A major part of ADMARC's lending to PHL arose from its use as an intermediary for the Reserve Bank (RBM). Thus the issue of income notes to ADMARC is on terms that will enable ADMARC to service its Press-related debt to RBM (currently estimated at about MK 38.0 million) on exactly equivalent terms, including the provision that, if Press falls into arrears, then ADMARC would reduce its own payments correspondingly.

PHL's liabilities to the banks are to be assumed by the Government, which will issue Special Local Registered Stocks (SLRS) at a fixed interest rate, amortized over 25 years in equal annual installments. In addition to the liability to the Government that it has thus acquired, PGL owed the Government MK 16.4 million on the effective date, arising from past government servicing of foreign loans on-lent to Press.1/ Thus PGL's total liabilities to the Government on the effective date amounted to MK 64.5 million, against which it will issue income notes and redeemable cumulative preference shares worth MK 28.5 million and MK 36.0 million, respectively. Both will carry an interest rate of 10 percent, but the income notes will be amortized on a fixed schedule (25 years including 5 years' grace), whereas the preference shares will be redeemed only as the company's financial position permits.

The restructuring exercise was based on the need to minimize the impact on the government budget, although it was recognized that some additional net cost would be incurred by the Government, particularly in the initial stages of the exercise. Prior to the restructuring the Government had carried the full burden of servicing external loans (amounting to MK 15.4 million in June 1983) that it had intermediated for Press. The Government will continue to service these debts, which it has formally assumed in return for taking direct control over Dwangwa shares in addition to the income notes. It will also start immediately to service the SLRS issued to the banks, an amount of about MK 7.6 million in the first full year, diminishing gradually over the life of the SLRS.

1/ The amount has been reduced by transferring to the Government PHL's former equity holdings in the two commercial banks and the Dwanga Sugar Corporation worth, respectively, MK 2.4 million and MK 3.7 million. PHL's holdings in Dwangwa amounted to MK 8.5 million, of which MK 4.8 million was transferred to ADMARC in partial redemption of PHL's liabilities, the remainder going to the Government.

Service on the PGL income notes and preference shares will be an amount equivalent to the Government's payment if all notes and shares are serviced fully. However, in the first years of operation PGL is not expected to be able to meet its obligations in full. Meanwhile, PGL would accumulate arrears to the Government that would be discharged as its financial position improves, the arrears taking priority over current liabilities to the Government 1/. The planned sale of assets by PITH will enable it to increase its payments to PCL and hence to PGL. This is unlikely to result in the accelerated redemption of the government income notes and preference shares; rather it may enable PGL to be more timely with scheduled payments.

To ensure that the restructured group operates on a commercial basis, guidelines have been drawn up, setting out policies on investment criteria, pricing policy, and practices relating to borrowing from the banks and to intercompany lending operations. Before becoming effective these guidelines will have to be formally adopted by the boards of the companies. The authorities are also considering possible amendments to the Banking Act that would be designed to prevent the recurrence of many of the problems that led the Press Group into its financial crisis. Among the issues that might be considered are the following: a statutory requirement that banks should make provisions against nonperforming loans; a limit on banks' lending to their shareholders; a limit on lending to any single borrower; and prescribing more carefully the circumstances in which bank officials can act as directors of other companies. The authorities are cautious about enacting legislation that might be difficult to enforce, and realize that the fundamental issue is the creation of an appropriate environment in which the Press group, like all other companies, can operate on a purely commercial basis.

4. Price liberalization

In September 1983 the Government introduced the first measure to liberalize the price control system by limiting the period allowed for processing price increase applications to a maximum of 60 days, failing which the requested increases would become effective automatically. As this procedure has worked fairly well up to now, the authorities have agreed to streamline the price control system even further by reducing the maximum processing period from 60 days to 30 days. This action will be implemented not later than April 1, 1984, the beginning of the fiscal year.

In addition, during 1984 the authorities will conduct a comprehensive review of the system of price controls aimed at progressively reducing the number of items currently controlled. As an initial step, on December 30, 1983 the authorities announced that, with immediate effect, prior approval would no longer be required for increases in the prices

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1/ At the request of the World Bank the legal agreement contains a provision that if arrears of interest exceed MK 15 million, then that amount should be converted to additional preference shares.

of 23 commodities. In addition, the authorities will announce price decontrol in respect of a further substantial list of commodities during the first quarter of fiscal year 1984/85 (April-March). Further action on price liberalization will take advantage of the report of a consultant appointed by the World Bank to study the price control system and propose recommendations for liberalization of this system in the near future.

5. Fiscal developments

a. Central government operations

A substantial adjustment was made to the overall deficit in 1982/83 (April/March), reducing it to 7.8 percent 1/ from 10.6 percent of GDP in 1981/82 (or from 14.0 percent to 10.5 percent if official transfers are excluded). The program for 1983/84, the first year of the extended arrangement, involved a further reduction in the deficit to 6.4 percent (9.0 percent excluding official transfers). The target level for total domestic financing was MK 30 million (1.8 percent of GDP), of which no more than MK 23.1 million was to come from the domestic banking system. This adjustment was to be achieved by limiting expenditure growth to 6 percent, thereby reducing the expenditure/GDP ratio from 27.1 percent to 25.5 percent; recurrent expenditure growth was to be restrained to 4 percent 2/ and development expenditure to 9 percent.

Staff estimates indicate that the fiscal targets for 1983/84 are likely to be achieved (Table 2). The overall deficit for 1983/84 is now estimated at MK 100.5 million or 6.1 percent of GDP (the program target is 6.4 percent), with domestic financing of MK 28.7 million (1.7 percent of GDP), of which MK 23.1 million is from banks. Although recurrent expenditure is expected to be about 3 percent above program projections, development expenditure is likely to turn out slightly less than the program projection, despite the effect of the September devaluation on the foreign currency component. Moreover, revenue is expected to grow by 15 percent, about 2.5 percentage points higher than the program forecast, thus permitting a small increase in the revenue/GDP ratio. Grants are also expected to be somewhat higher than forecast in the program.

1/ The program had estimated the deficit for 1982/83 at 7 percent of GDP. However, certain transactions (amounting to MK 11.4 million) that took place in 1982/83 and were not originally accounted for in that fiscal year have now been correctly attributed to 1982/83. A substantial part of the reclassified transactions (MK 7.9 million) relates to emergency fertilizer purchases, and all the reclassified items were foreign financed (MK 0.9 million in grants and MK 10.5 million in external loans).

2/ Exclusive of extrabudgetary expenditure in respect of emergency maize stocks and the Press reconstruction, recurrent expenditure was to increase by 2 percent.

Table 2. Malawi: Summary of Central Government Operations, 1980/81-1985/86

(In millions of Malawi kwacha)

	1980/81	1981/82	1982/83	1983/84 Prog.	1983/84 Revised	1984/85 Proj.	1985/86 Proj.
Total revenue and grants	242.5	263.2	282.4	314.9	324.2	374.4	410.6 1/
Revenue	199.2	221.0	243.1	272.9	279.1	323.4	357.6
Of which: tax revenue	(166.9)	(179.1)	(207.7)	(230.6)	(234.1)	(275.9)	(306.1)
Grants	43.3	42.2	39.3	42.0	45.1	51.0	53.0
Total expenditure	358.6	392.8	395.7	419.8	424.7	474.4	518.4 2/
Recurrent	183.7	268.6	260.7	272.3	280.2	304.4	335.8
Development	174.9	124.2	135.0	147.5	144.5	170.0	182.6
Additional fiscal measures	--	--	--	--	--	--	7.8 3/
Overall surplus/deficit (-)	-116.1	-129.6	-113.3	-104.9	-100.5	-100.0	-100.0
Financing	116.1	129.6	113.3	104.9	100.5	100.0	100.0
Foreign	40.0	31.3	71.4	74.9	71.8	72.0	70.0
Borrowing	(62.3)	(63.1)	(85.2)	(84.3)	(87.5)	(112.0)	(117.0)
Repayments	(-22.3)	(-31.8)	(-13.8)	(-9.4)	(-15.7)	(-40.0)	(-47.0)
Domestic	76.1	98.3	41.9	30.0	28.7	28.0	30.0
Banking system	(48.1)	(85.7)	(15.8)	(23.1)	(...)	(20.0)	(...)
Other domestic	(28.0)	(12.6)	(26.1)	(6.9)	(...)	(8.0)	(...)
			(In percent of GDP)				
Total revenue and grants	23.1	21.5	19.3	19.1	19.7	20.2	19.7 1/
Revenue	19.0	18.0	16.7	16.6	16.9	17.4	17.2
Of which: tax revenue	(15.9)	(14.6)	(14.2)	(14.0)	(14.2)	(14.9)	(14.7)
Grants	4.1	3.4	2.7	2.6	2.7	2.7	2.5
Total expenditure	34.2	32.1	27.1	25.5	25.8	25.5	24.9 2/
Recurrent	17.5	21.9	17.9	16.5	17.0	16.4	16.1
Development	16.7	10.1	9.2	9.0	8.8	9.2	8.8
Additional fiscal measures	--	--	--	--	--	--	0.4 3/
Overall surplus/deficit (-)	-11.1	-10.6	-7.8	-6.4	-6.1	-5.4	-4.8
Financing	11.1	10.6	7.8	6.4	6.1	5.4	4.8
Foreign	3.8	2.6	4.9	4.5	4.4	3.9	3.4
Domestic	7.3	8.0	2.9	1.8	1.7	1.5	1.4
Of which: banking system	(4.6)	(7.0)	(1.1)	(1.4)	(...)	(1.1)	(...)

Sources: Ministry of Finance; and staff estimates.
1/ Assuming discretionary measures taken in 1984/85.
2/ Scenario described in text.
3/ Revenue measures or cuts in expenditure from assumed scenario.

b. Revenue in 1983/84

During the first eight months of the fiscal year 1983/84, total revenue was up almost 19 percent over the similar period in the previous year, with tax revenue registering an 18 percent increase (Appendix Table III); for the whole year increases had been projected of 15 percent and 13 percent, respectively. The most buoyant component of tax revenue consists of taxes on domestic goods and services, which are expected to increase by 18 percent, a result, in part, of new domestic sales taxes, increased excise duties, and increased motor vehicle taxes. Taxes on income are expected to increase by 9 percent, with personal income taxes expected to increase by 14 percent.1/ Nontax revenue in 1983/84 is expected to increase by 27 percent over 1982/83 and to be 6 percent above program projections.

c. Expenditure in 1983/84

Total expenditure in the first eight months of 1983/84 was 18 percent higher than in the same period in the previous year (Appendix Table IV).2/ However, for the year as a whole, the increase is estimated to be only 7 percent, with the same rate of increase being registered by both recurrent and development expenditure. Recurrent expenditure is estimated to be about 3 percent above program projection, due in part to the effects of devaluation on foreign interest expenditures but principally to higher expenditure on goods and services (other than wages and salaries). The budgeted allocations for goods and services may have been unduly restrictive: the 1983/84 budget estimate was 9.5 percent less in nominal terms than the 1982/83 outturn. The component of expenditure showing the largest increase is expenditure on wages and salaries, which is expected to be about 14 percent above last year's level. This has occurred in spite of the freeze on the general salary scale, which has not been increased since January 1982. It reflects an 11 percent increase in established posts, and normal salary increments (which add about 5 percent annually to the wage bill). Development expenditure is now forecast to be slightly below the program projection, despite the effect of the September devaluation.

Fiscal year 1983/84 is the first full year of operation of the expenditure monitoring system introduced to provide greater control over government expenditure. Each month the Treasury instructs the Reserve Bank to credit individual Ministry accounts with an amount that, under present procedures, corresponds to the monthly prorated amount of its recurrent budget. Expenditure by a Ministry in excess of its cumulative allowance has to be cleared with the Treasury by the Reserve Bank, which monitors the account balances daily. A separate system operates for

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1/ PAYE deductions, the principal contributor to personal income taxes, are expected to grow at 17 percent, with other components showing little growth. The fast growth of PAYE deductions is, in part, due to a restructuring of personal income taxes in April 1983, which included the abolition of personal allowances.

2/ The high growth rate in the first half was due to the unusually low level of goods purchased in 1982/83 in the first half of the year.

development expenditure, due to the uneven phasing of these purchases and their large externally financed component. The monitoring system seems to be operating reasonably satisfactorily. Since the introduction of the monitoring system, substantial government deposits have accumulated, caused in part by the unused balances of certain ministries being carried forward from month to month without limit. During the review the staff pointed out the additional cost and inefficiency involved in such balances. The authorities are now examining various methods of reducing these balances and of maintaining closer surveillance over flows into and out of the accounts.

d. Fiscal framework for 1984/85 and outlook for 1985/86

The mission discussed with the authorities the preliminary framework of the fiscal year 1984/85 and the scale of the fiscal measures needed to bring projections within the original program targets. In the absence of new measures it is estimated that tax revenue would grow by 12 percent, its ratio to GDP falling slightly, while nontax revenue would rise by only 1 percent.1/ Total revenue would increase by 10 percent, falling from 16.9 percent to 16.6 percent of GDP. Under this scenario, recurrent expenditures would grow by 12 percent, based on interest expenses (including Press reconstruction expenditures), no general increase in wages and salaries, and no real increase in other recurrent expenditures. Development expenditure is broadly consistent with the core public sector investment program, and would represent an increase of 15 percent on the estimated level for 1983/84. Based on this scenario, and the program's target of a fiscal deficit of 5.4 percent of GDP, there would be a fiscal gap of about MK 23 million (1.2 percent of GDP).

Preliminary discussions were held with the authorities on closing this gap, either by containing expenditure growth or by taking revenue measures. Given the weakness of revenue performance in recent years, particular emphasis was placed on this area. The authorities have decided to take revenue measures amounting to MK 16.2 million. The remainder of the gap will be closed by exercising tighter restraint over expenditure; recurrent expenditure will therefore increase by 8.6 percent over the projected level for 1983/84, while development expenditure will rise by 17.6 percent (Table 2). In order to achieve these objectives it will be necessary to maintain wage and employment restraint during 1984/85, even though the authorities anticipate strong pressure for a significant increase after more than two years without adjustment. Any general wage increase would increase the scale of fiscal adjustment needed to achieve the 1984/85 target, since only a 5 percent allowance for wage drift has been made in the preliminary budget estimates.

The mission also examined with the authorities an illustrative scenario for 1985/86, based on assumptions similar to those used in the projections for 1984/85 except that allowance is made for a 10 percent

1/ The slow growth of nontax revenue is due to the fact that no ADMARC contribution has been included in the projection for 1984/85. Nontax revenues net of the ADMARC contribution are projected to grow at 17 percent.

general salary adjustment (Table 2). If adequate measures are taken to close the gap for 1984/85, then these would contribute most of the resources needed to achieve the 1985/86 program target deficit/GDP ratio of 4.8 percent.1/

6. Public sector investment program

The public investment program adopted by the authorities represents the first such plan to be prepared in Malawi. Previously, government investment plans had been formulated in the context of the annual budgetary exercise, but no attempt had been made to construct an overall strategy that would embrace the parastatal sector also. The program adopted by the authorities has been accepted by the World Bank as realistic and appropriate with respect to the SAL II operation approved by the Bank's Board on December 20, 1983. With respect to the Central Government, the investment program has formed the basis for the preliminary preparation of the development budget for 1984/85 and will continue to be used in this way in future years, subject to prevailing economic conditions.

The investment program is made up of a core of high priority projects, the implementation of which requires the mobilization of additional foreign assistance. To this end, Malawi has planned a Donors' Conference, scheduled for February 27-29, 1984, and will present to the participants the core public investment program, as an indication of the country's development strategy, together with a more comprehensive program that would be implemented should resources become available. Even if substantial new commitments were forthcoming, the authorities have recognized that the resultant financial flows will not materialize before the later years of the program, because of project gestation periods and normal appraisal and disbursement procedures.

Since the start of the arrangement the authorities have continued to refine the investment program, identifying and describing projects in greater detail, including estimates of individual project cost. The core program entails an expenditure of MK 531.6 million over the three fiscal years 1983/84-1985/86. Investment in transport will absorb 27.6 percent of the total, while agriculture and related activities will claim 21.8 percent. Other significant sectors will be education (10.3 percent), forestry (9.8 percent), health (5.4 percent), water and sanitation (5.2 percent), posts and telecommunications (5.8 percent), and power (2.9 percent). The remaining 11.2 percent will be devoted to a variety of projects, mainly for infrastructural development and services.

1/ Despite the allowance for the general wage increase, the gap does not increase dramatically. The reason is that interest expenditures of the Government are scheduled to fall slightly in 1985/86.

7. Medium-term savings prospects

Recent developments have been broadly in line with those originally anticipated in the program, so that no major revisions were required in the basic economic framework. With regard to the balance of payments, the larger deficit in 1983 was due to shortterm disruptions in transport and delays in World Bank SAL II disbursements. Thus the average annual growth rate of real GDP, projected at 3.5 percent for the program period, appears achievable, and the expected growth rates of GDP and the associated deflator for the individual years 1984-86 (Appendix Table II) are in line with the program forecasts. The realization of these growth rates is estimated to require an increase in the proportion of GDP devoted to gross fixed capital formation from 15.3 percent in 1982 to 19.4 percent in 1986 1/ and an increase in the domestic savings ratio from 14.4 percent to 17.6 percent in the same period (Table 1).

During the review a preliminary examination was conducted of the economy's ablity to generate this increase in saving, with particular reference to the public sector, including the statutory bodies. The potential for investment among the statutory bodies is severely limited by their substantial accumulation of indebtedness, both domestic and external, the servicing of which will represent a major drain on their resources during the period of the program. Nevertheless, the continuation of appropriate policies on cost control and regular tariff reviews will allow the major statutory bodies to generate some additional saving over the period of the program (Table 1). However, the major part of the increase in public sector saving is expected to come from the Government, which, in line with the program's objectives, will cease to be a dissaver after 1985. The "other sectors," a residual category that provided over 100 percet of gross domestic saving between 1981 and 1983, will continue to play a central role in generating saving.2/ However, the proportion of total domestic saving required from this sector is projected to fall from 101.2 percent in 1983 to 83.8 percent in 1986. The ratio of these other sectors' saving to GDP is expected to rise only marginally from 14.4 percent in 1983 to 14.8 percent in 1986, and will then be somewhat less than that achieved in 1982. This degree of savings effort appears to be consistent with that realized in previous years by the private sector and will be induced by several policy measures already taken including the increases in producer prices, the liberalization of the price control system, and the expansion of infrastructure and extension services. During the preparation of the second year of the program the authorities have been requested to provide more detailed medium-term forecasts for those enterprises that are subsidiaries of statutory bodies (at present classified under the "other sectors" category), thus enabling a more disaggregated analysis of the economy's capacity to generate

1/ If stockbuilding is included, the increase in total capital formation required is from 20.5 percent to 21.7 percent between 1982 and 1986.

2/ This sector includes a large number of companies in the Press group, and others wholly or partly owned by the Government, that are subsidiaries or associates of the major statutory bodies but are not included in the latter category.

resources. It is clear that the realization of the program's growth targets depends critically on the authorities' ability to improve the Government's saving performance, thus re-emphasizing the importance of adhering to the program's budgetary targets.

8. Monetary developments

The movements of the principal credit aggregates during 1983 were broadly in line with the original program estimates. However, the net foreign assets fell by MK 61.4 million in the year to December 1983 (Table 3), as opposed to the MK 17.7 million forecast in the program, because of the larger balance of payments deficit, as well as the depreciation of the Malawi kwacha. The larger balance of payments deficit was due in part to the nondisbursement of the first tranche of the IBRD's second structural adjustment loan before the end of the year. The other substantial variations occurred in the liabilities of the Reserve Bank: the item distinguished as the long-term liabilities of the Reserve Bank of Malawi (RBM) was reduced in conformity with the treatment of domestic counterparts of rescheduled external loans 1/; and there was a sharp fall in the reserves of the RBM (amounting to MK 17.0 million) in September 1983, following the revaluation of its assets after the devaluation in that month. The result of these various developments has been that broad money grew somewhat more slowly than expected--8.7 percent rather than 12.7 percent.

Credit to the private sector rose by 20.0 percent between 1980 and 1982, and by a further 16.3 percent in 1983. A large part of the increase however, represented the capitalization of interest on loans to the agricultural sector and the Press Group. The aggregate of credit to the private sector in the monetary survey includes capitalized interest that has been added to loan balances, estimated at MK 62.9 million in December 1983 (Table 3). If capitalized interest is netted out of gross bank credit to the private sector (Table 3), it is found that the underlying increase in private sector credit between December 1980 and December 1982 was only 3.9 percent, while the rise in 1983 was only 6.9 percent. The commercial banks observed little increase in the demand for new credit during 1983, except in activities related to external trade, where transportation difficulties and higher costs created additional financial requirements.

The restructuring of the Press group's finances will result in substantial changes in the monetary survey presentation. The issue of the Special Local Registered Stock (SLRS), in the transfer of Press' debt to the Government, will cause a reduction in the banking sector's credit to the private sector. In exchange the commercial banks will acquire an asset, unique in Malawi, that represents a claim on the Government that neither arises from direct public expenditure nor, for the most part, is expected to enter the definition of assets in the statutory

1/ Under this arrangement institutions whose external debt has been rescheduled are expected to continue servicing the debt in domestic currency, the proceeds being held in blocked accounts in the RBM. The procedure applies to the RBM's own liabilities, and so it has reduced the items shown in the monetary survey.

Table 3. Malawi: Monetary Survey, 1981-84

(In millions of Malawi kwacha)

	1981		1982		1983						1984
	March	Dec.	March	Dec.	March	June	Sept.		Dec.		March 1/
							Prog.	Act.	Prog.	Act.	
Foreign assets (net)	-86.8	-99.3	-137.8	-145.0	-172.8	-162.8	-171.7	-173.1	-185.0	-206.4	-195.0
Gross foreign assets	45.8	51.0	32.2	33.9	39.6	49.7	...	29.9	...	31.0	...
Foreign liabilities	-132.6	-150.3	-170.1	-178.9	-212.4	-212.5	...	-203.0	...	-237.4	...
Net domestic assets	345.0	403.7	438.5	474.5	487.0	519.8	538.3	534.4	555.2 2/	546.5	548.3 2/
Net domestic credit	356.3	421.6	466.3	495.8	511.0	541.0	559.3	554.4	576.2	571.9	569.3
Credit to Government	115.3	167.8	201.0	211.3	216.9	231.8	244.3	240.4	254.7 2/	252.7	240.0 2/
Special Local Registered Stock	...	...	...	...	...	...	...	...	...	...	54.2
Credit to statutory bodies	58.3	62.0	56.9	65.5	62.3	69.7	66.0	65.4	65.0	64.5	65.0
Credit to private sector	182.7	191.8	208.4	219.0	231.8	239.5	249.0	248.6	256.5	254.7	210.1
Of which: capitalized interest	(12.9)	(22.8)	(26.7)	(39.6)	(44.6)	(50.2)	(...)	(55.5)	(...)	(62.9)	(...)
Other assets (net)	-11.3	-17.9	-27.8	-21.3	-24.0	-21.1	-21.0	-20.0	-21.0	-25.4	-21.0
Long-term liabilities of Reserve Bank	9.1	9.1	9.1	10.2	5.2	5.2)		2.8)		2.8)	
SDR allocation	11.6	11.6	11.6	13.3	13.3	13.3)	56.0	14.9)	52.0	14.9)	56.0
Capital accounts	34.2	42.2	46.0	29.7	32.2	35.2)		20.1)		21.9)	
Money plus quasi-money	203.3	241.4	234.0	276.4	263.5	303.3	310.6	323.5	318.2	300.5	297.3
Money	103.8	114.8	106.1	130.8	111.7	139.5	...	150.4	...	135.5	...
Currency outside banks	32.9	39.4	37.1	49.5	44.9	59.5	...	63.4	...	50.0	...
Demand deposits	70.9	75.4	68.9	81.3	66.8	80.0	...	87.6	...	85.5	...
Quasi-money	99.5	126.6	127.9	145.6	151.8	163.8	...	174.4	...	165.0	...
Memorandum item:											
Credit to private sector net of capitalized interest	169.8	169.0	181.7	179.4	187.2	189.3	...	193.2	...	191.8	...

Sources: Reserve Bank of Malawi; and staff estimates.
1/ Revised estimates.
2/ Performance criteria; the decline in the ceilings in March 1984 is due to the anticipated receipt of the first tranche of the World Bank's SAL II. The March 1984 ceilings have been maintained unchanged from the original program indicative limits.

liquidity ratios and so would have no direct impact on monetary expansion. For these reasons the issue of SLRS is reflected separately in the monetary survey (Table 3).

Interest rates on time and savings deposits were increased in June 1983 by two percentage points, bringing the range of interest rates on such deposits to 10.75-13.5 percent. At the same time maximum lending rates were reduced from 18.5 percent to 16.5 percent, but, since almost no loans are extended at the highest rates, the effect was to maintain average effective rates at their previous level of about 14.5 percent. With preliminary evidence showing a deceleration in the rate of inflation, all real interest rates were positive with respect to the high-income price indices in the year to October 1983,1/ and the present structure of interest rates appears to be appropriate. Surveillance will have to be exercised to ensure that the operating margins of the financial institutions are not unduly squeezed by the simultaneous increase in deposit rates and reduction in lending rates.

The commercial banks have, in the past, provided 100 percent of seasonal financing for the agricultural sector, and have also effectively been the source of longer term finance. They now wish to reduce the extent of their exposure, particularly in medium- and long-term operations, because of constraints on their own resources and the sector's poor record of loan performance. The authorities have discussed with the World Bank a timetable for developing a program designed to provide a source for such nonseasonal finance. There would be no need, in the first instance, for a new institution, and the facility could take the form of a new "window" in an existing agency. The Industrial Development Bank (INDEBANK) has been suggested as a possibility, since it has experience in project appraisal, albeit in another sector, and has a record of sound financial performance and appraisal techniques.

9. External policies

a. The balance of payments in 1983

The balance of payments position continues to be subject to unfavorable developments in the terms of trade and external transportation routes. As a consequence of the redirection of transportation routes, the c.i.f./f.o.b. margin increased from 20-25 percent in the late 1970s to 30 percent in 1982 and 36 percent in 1983. Moreover, the terms of trade declined sharply in 1983, mainly due to weak prices for tobacco, which fell by 29 percent. These unfavorable developments

1/ In the year to October 1983 the Blantyre and Lilongwe high-income indices rose by 10.8 percent and 8.9 percent, respectively, while the composite index of all indices rose by 9.1 percent and 11.7 percent, respectively, in the 6- and 12-month periods to October 1983 (on an annual basis). There was a temporary sharp increase in inflation in December 1983 in one of the four indices, raising the estimated rate of increase in calendar 1983 to 13.9 percent.

resulted in a current account deficit in 1983 slightly higher than envisaged in the program. The deficit, which was 17.4 percent of GDP in 1980 and 12.8 percent in 1981, was originally estimated at 9.1 percent of GDP in 1982 and was expected to decline to 8.0 percent the following year. Revised estimates, which include more accurate information on factor services in 1982 (especially interest payments, which are significantly lower than originally thought), indicate a current account deficit of SDR 101 million (8.3 percent of GDP) in 1982 and SDR 124 million (9.8 percent of GDP) in 1983. The increase from 1982 to 1983 in the deficit occurred because of the increase in net transport costs; imports (f.o.b.) in 1983 were unchanged in nominal terms from the level in 1982 (Tables 4 and 5) and the trade surplus in 1983 was higher than assumed in the program.

The capital account balance was lower than anticipated in the program but would have been slightly higher had the expected flow of US$25 million from the World Bank's second structural adjustment loan (SAL II) been realized. The Bank's Executive Board approved this loan on December 20, 1983, and disbursement of the first tranche (US$30 million) is now expected to commence in the first quarter of 1984. The preliminary estimates for 1983 show a relatively large negative flow on short-term capital and errors and omissions; this may reflect some underestimate of transport costs in 1983, as well as some outflows of short-term capital. The overall balance of payments deficit before debt relief is now estimated to increase from SDR 57 million in 1982 to SDR 104 million in 1983, instead of increasing only to SDR 68 million, as originally projected. The increase in the deficit, as compared with the program targets, was due entirely to the higher transport costs and the delay in the disbursement of the first tranche of the World Bank's SAL II.

b. External debt

The Malawian authorities, on October 27, 1983, reached agreement with their major creditors at the Paris Club for a second year of debt relief for 1983/84 on the same terms as for 1982/83, as assumed in the program. The London Club (commercial banks) agreement of 1982 also provided for a second year's rescheduling, which was subject to the conclusion of a second year's agreement with the Paris Club and the continuation of programs with the Fund and the World Bank. As a result of these agreements, the debt service ratio, which would otherwise have been 43.4 percent, was reduced to 36.7 percent in 1982 and is estimated to have fallen to 19.3 percent in 1983. The ratio is projected to rise to a peak level of 33.0 percent in 1985, the first year when repayments will start falling due under the rescheduling arrangements, and to decline thereafter (Table 6). For the program period the average debt service ratio after debt relief is expected to be about 29.0 percent, in line with the program projections.

While the Malawian Government had, in recent years, undertaken heavy borrowing in the international financial markets to finance budgetary outlays and investment projects, it now recognizes the need to restrain

Table 4. Malawi: Balance of Payments, 1982-83

(In millions of SDRs)

	1982		1983	
	Previous	Revised	Program	Revised
Current account	-106.3	-100.9	-105.1	-124.3
Trade balance	24.3	23.4	18.4	25.3
Exports, f.o.b.	212.1	216.7	220.5	219.7
Imports, f.o.b.	-187.8	-193.3	-202.1	-194.4
Services and transfers (net)	-130.7	-124.3	-123.5	-145.6
Nonfactor services (net)	-89.9	-89.4	-84.6	-114.6
Factor services (net)	-33.2	-27.0	-31.4	-26.7
Of which: interest payments	(-52.5)	(-39.2)	(-47.2)	(-38.9)
Private transfers	-7.5	-7.9	-7.5	-8.3
Capital account	51.6	43.9	37.2	20.4
Long-term capital	41.3	35.5	37.2	34.2
Government transfers (net)	28.5	32.9	33.0	35.9
Government borrowing (net)	29.9	20.3	25.5	18.0
Credit	(69.5)	(61.5)	(63.4)	(54.5)
Debit	(-39.6)	(-41.2)	(-37.9)	(-36.5)
Statutory bodies (net)	-14.4	-15.0	-15.9	-15.3
Private enterprises (net)	-2.6	-2.7	-5.4	-4.4
Short-term capital and errors and omissions	10.2	8.4	--	-13.8
Overall balance before debt relief	-54.8	-57.0	-67.9	-103.9
Debt relief	16.3	16.9	53.2	55.1
Overall balance after debt relief	-38.5	-40.1	-14.7	-48.8
Financing	38.5	40.1	14.7	48.8
Use of Fund resources (net)	-1.7	-1.7	26.4	26.4
Change in reserves	40.2	41.8	-11.7	22.4
Memorandum items:				
Current account deficit as percent of GDP	9.1	8.3	8.0	9.8
Current account deficit after debt relief (SDR million)	-102.3	-96.7	-97.6	-116.6

Sources: Data provided by the Malawian authorities; and staff estimates.

Table 5. Malawi: Balance of Payments, 1982-87

(In millions of SDRs)

	1982	1983	1984	1985	1986	1987
Current account	-100.9	-124.3	-98.8	-88.4	-95.6	-98.7
Trade balance	23.4	25.3	37.9	46.6	50.8	51.0
Exports, f.o.b.	216.7	219.7	248.1	286.0	320.3	338.3
Imports, f.o.b.	-193.3	-194.4	-210.0	-239.4	- 269.6	-287.3
Services and transfers (net)	-124.3	-145.6	-128.7	-135.0	-146.4	-149.7
Nonfactor services (net)	-89.4	-114.6	-99.9	-100.2	-112.7	-119.2
Factor services (net)	-27.0	-26.7	-29.4	-26.6	-24.5	-20.1
Of which: interest payments	(-39.2)	(-38.9)	(-44.0)	(-41.8)	(-40.4)	(-36.9)
Private transfers	-7.9	-8.3	-7.6	-8.2	-9.2	-10.4
Capital account	43.9	20.4	63.3	89.5	112.4	127.4
Long-term capital	35.5	34.2	63.3	89.5	112.4	127.4
Government transfers, net	32.9	35.9	37.7	41.3	48.9	52.6
Government borrowing, net	20.3	18.0	36.8	49.0	52.5	59.0
Credit	(61.5)	(54.5)	(71.6)	(82.3)	(81.6)	(83.7)
Debit	(-41.2)	(-36.5)	(-34.8)	(-33.2)	(-29.1)	(-24.7)
Statutory bodies, net	-15.0	-15.3	-10.4	-3.2	4.7	4.7
Private enterprises, net	-2.7	-4.4	-0.8	2.4	6.3	11.0
Short-term capital and errors and omissions	8.4	-13.8	--	--	--	--
Overall balance before debt relief	-57.0	-103.9	-35.4	1.1	16.7	28.7
Debt relief 1/	16.9	55.1	25.8	-7.8	-15.1	-22.1
Overall balance after debt relief	-40.1	-48.8	-9.6	-6.7	1.6	6.6
Financing	40.1	48.8	9.6	6.7	-1.6	-6.6
Use of Fund resources (net)	-1.7	26.4	7.5	21.0	5.1	-22.6
Change in reserves	41.8	22.4	2.1	-14.3	-6.7	16.0
Memorandum items:						
Current account deficit as percent of GDP	8.3	9.8	7.0	5.6	5.4	5.0
Current account deficit after debt relief (SDR million) 2/	-96.7	-116.6	-98.3	-91.8	-100.1	-103.2

Sources: Data provided by the Malawian authorities; and staff estimates.

1/ Debt rescheduling is assumed only up to mid-1984. Repayments of rescheduled debt start in 1985 and are reflected as negative flows.

2/ Reflects higher actual interest payments in 1985-87.

Table 6. Malawi: Debt Service Projections and Indicators, 1982-87

(In millions of U.S. dollars)

	1982	1983	1984	1985	1986	1987
Debt service before relief 1/						
Principal	68.3	64.6	63.5	57.1	51.4	46.3
Interest	31.6	30.7	36.6	32.9	29.6	26.7
Total	99.9	95.3	100.1	90.0	81.0	73.0
Debt relief 2/						
Principal	14.8	50.9	29.1	-3.9	-13.7	-20.6
Interest	3.9	8.0	0.5	-5.0	-3.6	-4.7
Total	18.7	58.9	29.6	-8.9	-17.3	-25.3
Debt service after relief 1/						
Principal	53.5	13.7	34.4	61.0	65.1	66.9
Interest	27.7	22.7	36.1	37.9	33.2	31.4
Total	81.2	36.4	70.5	98.9	98.3	98.3
Fund credit						
Repurchases	12.6	9.9	21.4	15.8	22.0	23.7
Charges	7.3	5.7	8.5	10.8	13.2	13.5
Total	19.9	15.6	29.9	26.6	35.2	37.2
Total external public debt						
Principal	66.1	23.6	55.8	76.8	87.1	90.6
Interest	35.0	28.4	44.6	48.7	46.4	44.9
Total	101.1	52.0	100.4	125.5	133.5	135.5
Debt service ratios 3/						
Before rescheduling	43.4	40.5	39.5	30.8	27.4	26.0
After rescheduling	36.7	19.0	30.5	33.2	31.5	32.0

Sources: IBRD; data provided by the Malawian authorities; and staff estimates.

1/ Includes scheduled service on public and publicly guaranteed debt outstanding as of May 31, 1983 (Central Government and statutory bodies) as well as debt service on projected commitments for the period June 1983-December 1987.

2/ Repayments of rescheduled debt start in 1985 (negative numbers).

3/ Including Fund credit.

external borrowing within the framework of overall credit policy and the debt servicing capacity of the country. Thus, Malawi did not contract any nonconcessional debt of less than 12 years maturity in 1983, and the authorities have agreed to continue to operate with very stringent limits in 1984.

Under the SAL I arrangement with the World Bank, the Malawian Government established a debt-monitoring unit in the Ministry of Finance, under which a consultant was hired to help design a debt management system. In the course of SAL II, the Government will ensure that the system for debt monitoring and planning is operating before release of the second tranche of SAL II, which is subject to a performance review in April 1984.

The program's medium-term balance of payments objective remains basically unchanged: i.e., to strengthen Malawi's external position so that the current account deficit can be reduced to 7.0 percent of GDP in 1984 and 5.6 percent in 1985, a level sustainable under the current net capital inflow projections, even if there were no further debt relief after 1983-84 (Table 5).

Current indications are that the program's policies are strengthening the production of Malawi's traditional export crops, as well as creating the potential for some other exports. In this regard the maize surplus of the past two years has allowed the accumulation both of adequate domestic strategic reserves and a substantial exportable surplus. Many neighboring countries are unable to produce sufficient for their own requirements, a situation aggravated by prolonged drought in several countries of the southern African region. This has created potential markets for maize exports from Malawi, although severe foreign exchange constraints have limited the food-deficit countries' ability to finance such purchases, except where international food aid has been made available.1/ Malawi has also undertaken rapid expansion of its sugar production since 1980, a large proportion (about 75 percent) of which is destined for export. However, the combination of low sugar prices and the current transport problems have adversely affected sugar exports, with the result that large stockpiles have accumulated; these developments are expected to ease over the medium term.

Exports are projected to grow at an average annual rate of 10.5 percent over the program period. This implies a gradual improvement in the terms of trade after the severe deterioration in 1983 caused by weak tobacco prices. Imports f.o.b., which stagnated in 1983 following a sharp fall in 1982, are expected to increase at an average annual rate of 8.4 percent for the program period. To restrain import demand, the authorities are committed to import substitution by increasing the production of goods for the domestic market using local materials, especially in the areas of textiles, furniture, and beverages.

1/ A significant proportion of the maize exports in 1983/84 have been financed by such international financial assistance.

Total net capital inflows are expected to increase during the program period, reaching SDR 90 million in 1985, thus eliminating the deficit in the overall balance of payments. Capital inflow projections reflect the financing plans for projects in the public sector investment program, take account of disbursements under SAL II, and assume the satisfactory conclusion of a third SAL. Further, the authorities plan to hold a donors' conference in Lilongwe early in 1984, under the auspices of the UNDP, and hope to mobilize further concessional assistance from both existing and new donors in support of Malawi's medium-term economic program. No net inflows of short-term capital are assumed during the program period.

The devaluation of the Malawi kwacha in September 1983 and the authorities' commitment to a more flexible exchange rate policy are expected to enhance the improvement in the balance of payments. Continued prudence is required and appropriate policies will continue to be needed in the future in order to strengthen the balance of payments, particularly in view of the currently low level of foreign exchange reserves. Gross reserves are projected to remain at levels equivalent to about one month of imports during the program period.

c. Exchange and payments system

The program provided for a 12 percent devaluation of the kwacha to correct for the appreciation of its real effective exchange rate since the devaluation of April 1982 (Table 7 and Chart 2), and a change in the currency peg from the SDR to a more appropriate basket of currencies in order to avoid further unintended appreciation of the kwacha's real effective exchange rate.

The exchange rate adjustment was implemented ahead of schedule by the authorities. As a prior action to the approval of the EFF paper, a 5 percent adjustment was made in September 1983, which was to be followed by a gradual downward float for a cumulative depreciation of a further 7 percent over the following six-month period. Instead, the authorities implemented the full 12 percent devaluation of the kwacha (in local currency terms) in September 1983.

Effective January 17, 1984, the Malawian authorities changed the currency peg from the SDR to a trade-weighted basket, and at the same time effected a 3.3 percent devaluation in domestic currency terms to offset the nominal effective appreciation that had occurred since the 12 percent devaluation of September 1983 (see EBD/84/21).

Malawi continues to maintain a liberal trade system and an exchange system that is free from restrictions on payments and transfers for current international transactions.

Table 7. Malawi: Effective Exchange Rates of the Kwacha, 1978-83

(Average 1980 = 100)

	Real	Nominal	Relative prices	CPI
1978	100.45	105.46	95.26	76.10
I	100.79	104.35	96.59	76.68
II	102.19	105.87	96.52	75.80
III	99.41	105.80	93.96	74.44
IV	99.42	105.81	93.96	77.48
1979	99.01	103.79	95.41	84.43
I	98.74	104.92	94.11	81.23
II	98.56	103.75	95.00	81.74
III	98.85	102.91	96.06	85.00
IV	99.88	103.56	96.45	89.74
1980	100.00	100.00	100.00	100.00
I	98.65	102.43	96.32	95.46
II	101.18	100.22	100.96	99.30
III	101.32	99.50	101.84	101.68
IV	98.83	98.12	100.72	105.52
1981	101.39	103.37	98.20	110.07
I	100.41	98.57	101.86	112.38
II	100.30	101.65	98.67	107.95
III	102.83	106.25	96.79	107.69
IV	102.02	106.84	95.49	112.27
1982	98.72	101.12	97.71	120.26
I	102.24	108.00	94.66	114.90
II	95.64	99.98	95.65	115.48
III	96.81	98.03	98.75	121.10
IV	100.20	98.46	101.77	129.55
1983	101.66	97.17	104.70	137.49
I	102.01	99.54	102.49	134.70
II	101.38	99.36	102.03	131.58
III	104.94	98.56	106.49	138.93
IV	100.87	91.81	109.87	150.07
1984				
Jan. (est.)	101.55	91.90	109.87	...
Feb. (proj.)	99.85	90.36	109.87	...

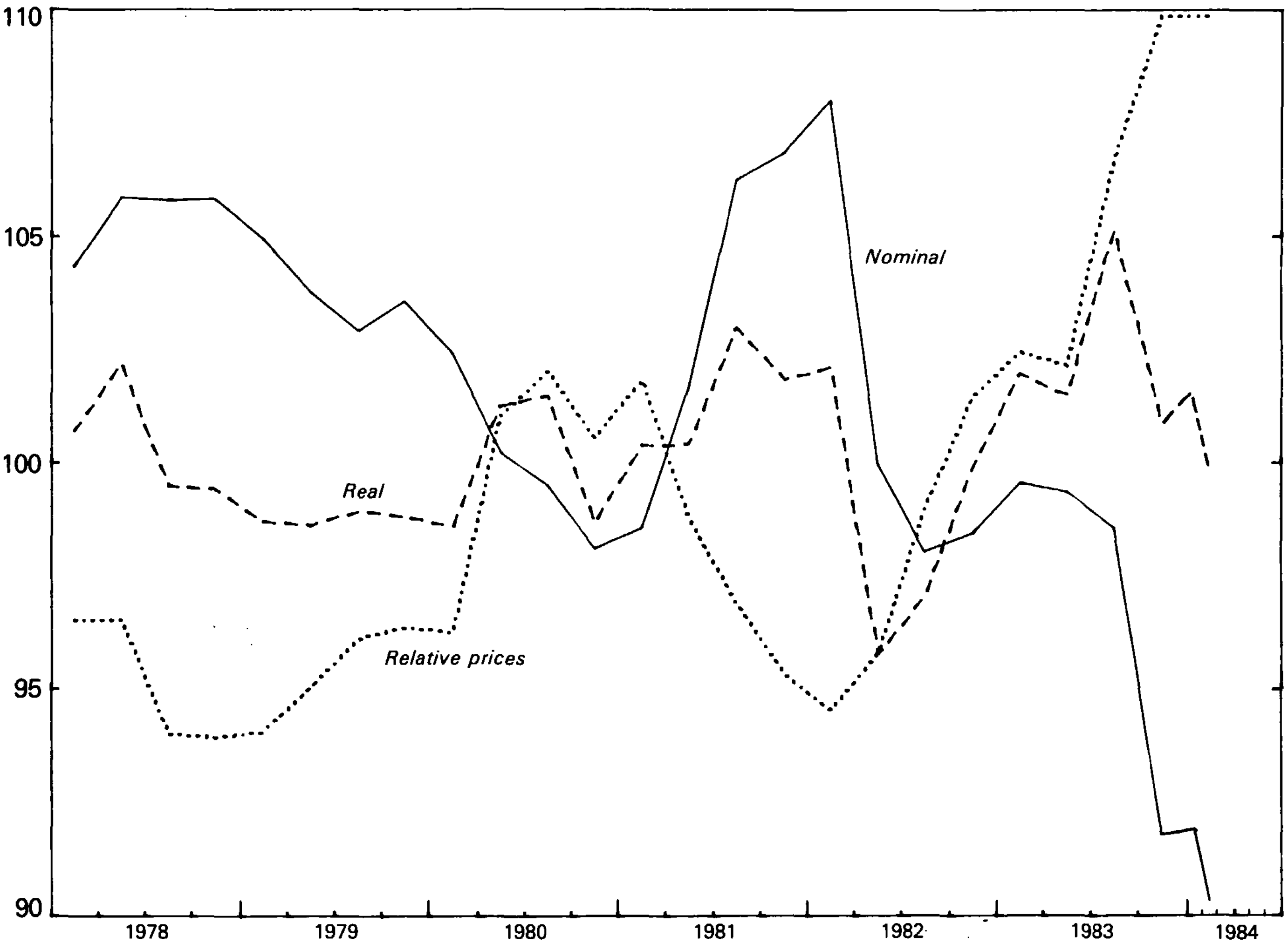
Sources: Data provided by the Malawian authorities; and IMF data and calculations.

CHART 2

MALAWI

EFFECTIVE EXCHANGE RATES, Q1 1978-FEB 1984

(Average 1980=100)



Sources: Data provided by the Malawi authorities; and IMF data and calculations.

10. Quantitative performance criteria

Performance criteria were established in the original program for September and December 1983 relating to the net domestic assets of the banking system, with a subceiling on the expansion of net bank credit to Government, and limits on the contracting or guarantee of new external loans (Table 8); indicative targets were provided for March 1984, with final undertakings to be reached during the first review. All the quantitative criteria were observed in September 1983, and in December 1983.

During the review understandings were reached on the ceilings for bank net domestic assets and net credit to the Government for March 1984, (the end of the current fiscal year) and on the limits for the contracting or guarantee of new nonconcessional external borrowing during 1984. With respect to bank credit the indicative targets established in the original preparation of the program were retained as formal performance criteria. This represents an increase in the degree of adjustment implicit in the first year of the program, since the indicative targets had been formulated before the size and timing of the devaluation of the kwacha were known.1/ Consistent with the need to maintain Malawi's debt service obligations at manageable levels, tight limits have been maintained on Malawi's external public sector borrowing. The ceilings established in 1983 will be maintained in 1984: borrowing in the maturity range 1-12 years will be limited to SDR 5 million, with none permitted in the range 1-5 years (Table 8). The Government does not intend to contract any borrowing of less than one year's maturity except for normal trade financing.

III. Staff Appraisal and Proposed Decision

Economic developments in Malawi during 1983 were broadly in line with those anticipated in the program, except for the larger balance of payments deficit which was due to higher transport costs and the temporary delay in the approval of the World Bank's SAL II. The recovery of real economic growth, which commenced in 1982, is estimated to have continued in 1983, largely as a result of the expansion of output in the agricultural sector. In spite of earlier fears of a further year of drought, rainfall during the year was adequate to allow increased production of some crops, particularly the principal export, tobacco; other crops, however, showed some decline. The increase in output was more than offset by a decline in tobacco prices, which caused deterioration both in the financial position of the producers and in the external terms of trade.

Malawi's economy continued to be seriously affected by the very low level of operations on the traditional rail routes to the Indian Ocean through Mozambique. Much traffic has been redirected to longer and more

1/ The devaluation was implemented earlier than expected, and consequently the initial adverse impact on the government budget was more substantial than the original projections had anticipated.

Table 8. Malawi: Quantitative Performance Criteria
Under the Extended Arrangement in 1983/84

	1983					1984
	March 1/	June 1/	Sept. Prog.	Sept. Act.	Dec. 2/	March 2/
			(In millions of Malawi kwacha)			
Net domestic assets of banking system 3/	487.0	519.8	534.4	538.3	555.2 5/	548.3 5/
Net bank credit to Government 4/	216.9	231.8	240.4	244.3	254.7 5/	240.0 5/
			(In millions of SDRs)			
New nonconcessional external borrowing contracted or guaranteed by Government in the maturity range (cumulative): 6/						
1-12 years maturity	--	--	--	5.0	5.0	5.0
1-5 years maturity	--	--	--	--	--	--

Sources: Letter of intent and policy memorandum of July 29, 1983; data supplied by the Malawian authorities; and staff estimates.

1/ Actuals.
2/ Performance criteria.
3/ Defined as money and quasi-money, long-term liabilities of the Reserve Bank, banking system capital accounts, and SDR allocations, less net foreign assets of the banking system.
4/ Defined as commercial banks' and Reserve Bank of Malawi's credit to the Government less government deposits, plus any use of the local currency counterpart of purchases from the Fund, plus external borrowing by the Government for balance of payments support.
5/ The credit ceilings for December 1983 and March 1984 were prepared on the assumption that disbursements under the second IBRD Structural Adjustment Loan for an amount equivalent to MK 25.0 million would be made in the first quarter of 1984. In the event that the disbursements exceed this amount, the ceilings on net domestic assets of the banking system and net bank credit to Government will be reduced by an equivalent amount.
6/ The authorities also intend not to contract any short-term borrowing other than for normal trade financing purposes.

costly routes, causing delays in the shipment of exports and the arrival of imports. These transportation difficulties and low export prices have caused a substantial accumulation of sugar stocks, now equivalent to 75 percent of annual production. The higher costs associated with trade re-routing were a major factor in the acceleration of inflation during 1983 to a level somewhat in excess of the program forecast. The authorities, accepting that the transportation problem is likely to persist for several years, are making commendable efforts to minimize the additional costs and to ensure a more orderly flow of exports and strategic imports. However, in the longer term Malawi will need to develop alternative routes and rehabilitate existing facilities.

Developments in the budget for 1983/84 are expected to be broadly in line with the program's objectives for the overall deficit and its domestic financing. Since the rate of depreciation of the Malawi kwacha has been larger than envisaged, maintaining the original budget targets has necessitated a larger budgetary adjustment during 1983/84 than originally envisaged. The framework for the 1984/85 budget discussed with the authorities also maintains the original program targets. It involves continuing tight restraint on real expenditure, and this requires that wage and salary costs be contained by limiting the size of any general increase and by instituting a freeze on employment.

If the program's projections for domestic resource mobilization are to be realized, it is particularly important that the government budget targets should be observed, since a major source of increase in domestic savings must come from the Central Government. The staff believes that the measures already taken by the parastatals, and the further measures that are planned, will result in a progressive increase in the profitability of the parastatal sector. These measures include a reduction in employment in several enteprises, streamlining management, regular reviews and adjustment of prices and tariffs, the rationalization of investment portfolios, and better monitoring of performance. However, the prolonged period of financial difficulty from which the parastatals are emerging, combined with substantial debt servicing obligations, means that their ability to generate investible resources will be limited. The substantial progress made in reorganizing the Press group of companies, in particular the conclusion of the legal processes establishing the new group structure, will enable the holding and subsidiary companies to concentrate on their primary operations and to restore profitability. In the judgment of the staff, an appropriate environment has been created for the Press group to operate on strictly commercial and industrial principles. Nevertheless, close monitoring will be required to ensure that the new group retains its independence, and that every effort is made to ensure the prompt service and eventual discharge of its financial obligations to its main creditors, ADMARC and the Government.

Price liberalization will play an important role in assisting the return to profitability and stimulating corporate saving. The measures taken during the first year of the program constitute an important move toward this objective, and further measures will be taken during the second year to achieve the eventual elimination of controls. The authorities have also recognized the importance of providing adequate incentives to producers; agricultural prices will be adjusted annually in future, using the principles agreed with the World Bank.

The balance of payments was weaker than expected in 1983. Although the underlying position was strengthened by the devaluation of September 1983, the outcome showed deterioration with respect to both the previous year and the earlier projections for 1983. Three factors largely accounted for this: external transport constraints, lower terms of trade, and smaller capital inflows than expected. The nondisbursement of the first tranche of the World Bank's SAL II accounted for the shortfall in capital inflow. This tranche is now expected to be disbursed in the first months of 1984, and this, together with the slight improvement projected in the terms of trade, should enable the target for 1984 to be achieved. The program's balance of payments targets will be strengthened by the adoption in January 1984 of the new currency basket more representative of Malawi's external trade. The successful conclusion of an agreement for a second year's debt relief with the Paris Club, and the almost complete cessation of nonconcessional borrowing, will help to restore Malawi's debt service burden to a more manageable level in future years. The Donors' Conference planned for February 1984 will be critical in ensuring that the capital inflows projected in the program are realized.

In the absence of major variations from the analysis underlying the original program, no substantial revisions have been made to the program's medium-term projections or targets. The staff believes that economic developments during the latter part of 1983, and the policy decisions already taken, represent substantial progress toward the objectives of the three-year arrangement. During the negotiation in April 1984 of the program for 1984/85, the second fiscal year of the extended arrangement, it will be necessary to ensure that policy actions continue to be sufficiently strong to achieve the original objectives and targets of the extended arrangement.

The attached letter to the Managing Director dated February 24, 1984 from the Minister of Finance and the Governor of the Reserve Bank contains the request that the arrangement be amended to allow Malawi to make the purchase of SDR 5 million on the observance of the performance criteria for end-March 1984, as long as the purchase is made before May 31, 1984. This will enable Malawi to purchase SDR 20 million (out of the total extended arrangement amount of SDR 100 million), based on successful implementation of the program during the fiscal year (April 1983-March 1984). Moreover, it will allow sufficient time to determine compliance with the performance criteria for end-March 1984.

Accordingly, the following draft decision is proposed for adoption by the Executive Board upon completion of the review of the extended arrangement with Malawi:

1. Malawi has consulted with the Fund in accordance with paragraph 4(b) of the extended arrangement with Malawi and paragraph 34 of the memorandum attached to the letter from the Minister of Finance and the Governor of the Reserve Bank of Malawi dated July 29, 1983, attached to the extended arrangement for Malawi (EBS/83/183, Supplement 1) in order to review progress under the program and to reach understandings subject to which further pruchases may be made by Malawi under the extended arrangement.

2. The letter from the Minister of Finance and the Governor of the Reserve Bank of Malawi dated February 28, 1984 shall be annexed to the extended arrangement for Malawi, and the letter of July 29, 1983 attached to the extended arrangement shall be read as supplemented by the letter of February 28, 1984. Accordingly, the understandings referred to in paragraph 4(b) of the extended arrangement for Malawi relating to domestic assets of the banking system, net bank credit to the Government, and external borrowing shall be those specified in paragraphs 7 and 8 of the letter of February 28, 1984.

3. With respect to the additional matters referred to in paragraph 34 of the letter dated July 29, 1983, the Fund finds that no further understandings are necessary.

4. The extended arrangement for Malawi shall be amended as follows:

(a) Paragraph 2(a) shall be amended to read:

"Until June 1, 1984, purchases under the extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 20 million, provided that purchases shall not exceed the equivalent of SDR 5 million until October 31, 1983; the equivalent of SDR 10 million until January 31, 1984; and the equivalent of SDR 15 million until April 30, 1984".

(b) In paragraph 4(a), replace "April 30, 1984" with "June 1, 1984."

(c) In paragraph 4(c), replace "April 29, 1984" with "May 31, 1984."

MALAWI - Relations with the Fund
(At January 31, 1984)

Date of membership:	July 19, 1965
Status:	Article XIV
Quota:	SDR 37.2 million (effective December 7, 1983)
Exchange rate system:	On January 17 the Malawi kwacha was delinked from the SDR and pegged to an unannounced basket of currencies. The U.S. dollar is the intervention currency and the Reserve Bank of Malawi's rates for the U.S. dollar are based on the U.S. dollar/SDR rate calculated by the Fund for the preceding day. The initial representative rate on January 17, 1984 was MK 1 = US$0.73706. On January 31, 1984 the rate was MK1 = US$0.73465.

	Millions of SDRs	Percent of quota
Fund's holdings of Malawi kwacha	132.5	356.3
Of which:		
credit tranches	28.5	76.6
extended fund facility	8.6	23.1
supplementary fund facility	27.5	74.0
enlarged access resources	10.0	26.8
compensatory financing facility		
cereals	13.7	36.8
exports	8.3	22.3
buffer stock financing facility	0.9	2.5
Amount to be repurchased	97.5	262.2

SDR Department:	Millions of SDRs	Percent of allocation
Net cumulative allocation	11.0	100.0
Holdings	1.4	13.1

Trust Fund:	Malawi received loans of SDR 6.2 million during the first period and SDR 8.4 million during the second period. The outstanding balance is SDR 14.2 million.

MALAWI - Relations with the Fund (concluded)

Direct distribution of profits from gold sales:	Malawi has received US$2.4 million.
Gold distribution:	12,837 ounces of fine gold

Recent contacts

A one-year stand-by arrangement for SDR 22 million was approved by the Executive Board on August 6, 1982 (EBS/82/126) and was reviewed during the last Article IV consultation held October 28-November 11, 1982 (EBS/83/27 and SM/83/25). In addition, a sugar buffer stock financing purchase for SDR 0.922 million was approved by the Executive Board on December 6, 1982 (EBS/82/201), while a drawing under the compensatory financing facility for SDR 12.2 million was approved on February 28, 1983 (EBS/83/28). Negotiations leading toward an extended arrangement for SDR 100 million were initiated by a staff team during February 19-March 4, 1983, continued during a subsequent staff visit June 15-July 5, 1983, and concluded during a visit by the Malawian authorities to Washington July 27-August 2, 1983. The Executive Board approved the arrangement on September 19, 1983 (EBS/83/183). The arrangement was reviewed by a staff mission that visited Malawi November 30-December 14, 1983 and during a subsequent staff visit January 24-28, 1984.

MALAWI - Relations with the World Bank Group

Since 1966, when Malawi's first IDA credit was approved, the World Bank Group has granted Malawi 31 IDA credits totaling US$410 million and 7 World Bank loans totaling US$91 million, of which 2 were on third-window terms. Of the entire funds committed, US$121 million (24 percent) have been for agricultural projects, US$103 million (21 percent) for education, US$110 million (22 percent) for roads, US$100 million (20 percent) for structural adjustment, US$38 million (8 percent) for power projects, US$3 million (1 percent) for development finance companies, and the remainder for a combination of projects including water supply, health, and technical assistance. In addition, between 1976 and 1980 the IFC provided US$25.2 million in funding, of which US$24.4 million were loans and the remainder equity. These amounts financed five separate projects covering a number of sectors, including textiles, sugar, ethanol production, and tourism.

The Bank's most recent commitments to Malawi, approved during December 1983, were a US$44.9 million loan (US$26.9 million on IDA terms) for a fifth highway project, an IDA credit of SDR 51.9 million (equivalent to US$55.0 million) for a second structural adjustment loan, and an IDA credit of SDR 1.4 million (US$1.5 million equivalent) for a second technical assistance project.

Malawi: Selected Economic and Financial Indicators, 1980-86

	1980	1981	1982	1983 Est.	1983	1984	1985	1986
					Program projections			
	(Annual percent changes, unless otherwise specified)							
National income								
GDP at constant market prices	-0.1	-0.3	3.0	3.1	2.7	3.0	4.0	4.5
GDP deflator	14.9	15.4	18.1	9.5	9.7	9.7	8.1	8.3
Consumer prices	18.3	9.6	9.4	15.4	13.0	10.0	8.0	7.0
External sector								
Exports, f.o.b. (millions of SDRs)	226.4	254.1	216.7	219.7	220.5	248.1	286.0	320.3
Imports, c.i.f. (millions of SDRs)	337.0	317.7	276.1	303.1	288.8	311.8	342.1	385.3
Non-oil imports, c.i.f. (millions of SDRs)	289.2	271.2	233.1	...	238.8	...	...	...
Export volume	13.6	-22.6	-1.0	20.6	12.6	8.9	2.7	4.8
Import volume	-9.1	-14.4	-14.2	1.2	0.6	6.4	3.5	6.2
Terms of trade (deterioration -)	-18.5	14.5	14.3	-18.3	-13.7	1.7	4.1	1.2
Nominal effective exchange rate, year-end (depreciation -)	-5.3	8.9	-7.8	-7.1	...	...	...	...
Real effective exchange rate, year-end (depreciation -)	-1.1	3.2	-2.0	0.8	--	--	--	--
Government budget 1/								
Revenue, including grants	9.4	8.5	7.3	14.8	14.6	15.9	9.4	...
Total expenditure	17.3	9.5	0.7	7.3	10.9	11.7	9.3	...
Money and credit 1/								
Domestic assets (increase) 2/	32.0	46.0	20.7	23.3	23.3	20.8 3/	18.6 3/	17.0 3/
Credit to Government (increase) 2/	28.9	42.2	6.8	8.8	8.8	8.1 3/	5.6 3/	4.9 3/
Money and quasi-money (M2) (increase) 2/	22.0	15.1	12.6	8.7	12.8	14.7 3/	14.6 3/	15.9 3/
Velocity (GDP relative to M2)	5.2	5.2	5.1	5.3	5.5	5.0 3/	4.9 3/	4.8 3/
Interest rate (annual rate, one-year savings deposits)	8.75	8.75	8.75	10.75	10.75	...	...	...
	(In percent of GDP)							
Central government budget deficit 1/								
Excluding official transfers	15.2	14.0	10.4	8.8	9.0	8.1	7.5	...
Including official transfers	11.1	10.6	7.8	6.1	6.4	5.4	4.8	...
Domestic bank financing 1/	7.3	8.0	1.1	1.4	1.4	1.1	1.0	...
Foreign financing 1/ 4/	3.8	2.6	4.9	4.4	4.6	3.8	3.4	...
Gross fixed capital formation	25.7	18.2	15.3	16.0	15.4	16.6	18.1	19.2
Gross domestic savings	11.8	13.4	14.4	14.2	13.3	14.1	16.6	17.5
Current account deficit								
Excluding official transfers	17.4	12.8	8.3	9.8	8.0	7.0	5.6	5.4
Including official transfers	13.4	9.1	5.6	7.0	5.5	4.3	3.0	2.6
External debt (inclusive of use of Fund credit) (in millions of SDRs) 5/	554.3	665.0	698.9	807.7	785.3	844.2	905.6	959.1
Debt service ratio 6/								
Before rescheduling	18.7	29.3	43.4	40.5	42.7	39.5	30.8	27.4
After rescheduling	18.7	29.3	36.7	19.3	22.0	30.5	33.2	31.5
Interest payments 4/ 6/	10.7	15.9	12.7	10.4	13.4	13.5	12.9	10.9
	(In millions of SDRs, unless otherwise specified)							
Overall balance of payments								
Before rescheduling	6.2	-34.4	-57.0	-103.9	-67.9	-35.4	1.1	16.7
After rescheduling	6.2	-34.4	-40.1	-48.8	-14.7	-9.6	-6.7	1.6
Gross official reserves (months of imports, c.i.f.)	2.0	1.7	0.9	...	1.2	...	...	...
External payments arrears	--	--	--	--	--	--	--	--

1/ Fiscal year beginning April 1.
2/ As a percentage of money and quasi-money at the beginning of the period.
3/ Based on projections for calendar years.
4/ After debt relief.
5/ End of period.
6/ In percent of exports of goods and nonfactor services. Based on data provided by the IBRD and including IMF charges and repurchases.

Lilongwe, February 28, 1984

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière,

1. Under the extended arrangement approved by the Fund's Executive Board on September 19, 1983, the Government of Malawi undertook to hold periodic consultations with the Fund to assess performance under the arrangement and to agree on the policies needed to achieve the objectives of the medium-term program. For this purpose, a Fund mission was in Lilongwe during the period November 30-December 14, 1983 to review progress during the first half of the current fiscal year (April 1983-March 1984), the outlook for the rest of the year, and budgetary prospects for the next fiscal year (1984/85).

2. As part of the medium-term program, Malawi has taken a number of measures in 1983. Strong restraint has continued to be maintained on government expenditures, there have been no general increases in wages during the year, deposit interest rates were raised in June (lending rates are positive in real terms), and the Malawi kwacha was devalued by 12 percent in September. Producer price increases were announced in July to encourage production in 1983/84, administrative procedures for price control have been simplified, and tariff increases have been implemented for parastatals, including the electricity supply company, the water boards and the railway. We have formulated, in cooperation with the World Bank, a medium-term public sector investment program, and have completed the arrangements for the organizational and financial restructuring of Press Holdings, a major conglomerate. Significant measures have been taken to reduce the unit costs and to improve the profitability of the parastatals.

3. Economic development in the first half of 1983/84 has been broadly as anticipated under the program. The real rate of growth of GDP is estimated at about 3 percent, with a large output in the agricultural sector (in 1983 Malawi had a surplus maize production and exported maize to neighbouring countries). The rate of inflation in 1983 was somewhat higher than assumed in the program, but this is due largely to external factors that are not expected to persist in future years. The fiscal performance has been largely in accordance with program projections. We have agreed with the mission on specific fiscal measures that will ensure that the overall budget deficit and domestic financing of the budget deficit in 1983/84 will be in accordance with program projections, despite the negative budgetary impact of the devaluation of September 1983. The overall balance of payments showed a larger deficit than expected, due to weaker export prices, higher cost of imports c.i.f., and lower capital inflows than projected in the program. Monetary growth was somewhat

lower than forecast, while credit developments were broadly in line with the program targets and the performance criteria for December 1983 were observed.

4. With regard to price control, on December 30, 1983 we announced that a substantial list of items would no longer be subject to price control. It is also our intention to reduce soon, from 60 days to 30 days, the maximum period for processing of applications for price increases; this action will be implemented not later than April 1, 1984 (the beginning of the fiscal year 1984/85), when the price control administration will be provided in the 1984/85 budget with such additional personnel as will be needed to implement the new procedure.

5. We have discussed the framework of the 1984/85 budget with the mission. We expect the deficit to conform to the projection made when the medium-term program was adopted earlier this year. We have discussed with the mission possible new revenue measures needed to maintain an adequate revenue effort in 1984/85. The detailed provisions of the budget, to be adopted after consideration within Government, will be communicated to the Fund by end-February 1984. We intend to continue restraint on wages and salaries with the objective of meeting the fiscal targets of the program. Accordingly, any general increase in wages will be met by fiscal measures additional to those discussed with the mission.

6. On January 17, 1984 the Malawi kwacha was pegged to a currency basket more representative of Malawi's external trade, thus replacing the SDR. At the same time the Malawi kwacha was devalued by a further 3.3 percent (in local currency terms).

7. In pursuance of the monetary and credit objectives of the program, the indicative targets previously established will be incorporated without change in the program. Accordingly, the net domestic assets of the banking system, which amounted to MK 534.4 million at the end of September 1983, will not exceed MK 548.3 million at the end of March 1984. Net domestic bank credit to Government, which amounted to MK 240.4 million at the end of September 1983, will not exceed MK 240.0 million at the end of March 1984. If a SAL II disbursement, currently expected to be made in the first quarter of 1984, exceeds the assumed level, equivalent to MK 25.0 million, then the ceilings on net domestic assets of the banking system, and net domestic bank credit will be reduced by an equal amount; if the disbursement is less than the equivalent of MK 25.0 million, then no adjustment will be made to the ceilings. Interest rates are positive with respect to the underlying rate of inflation, and we intend to maintain a policy of flexible interest rates.

8. In view of the external payments and debt situation, external borrowing on nonconcessional terms will be limited. In 1984, the contracting or guarantee by the Government of new nonconcessional external borrowing of maturity of 1-12 years is to be limited to SDR 5 million, of which none shall have maturity less than 5 years. The authorities do not intend to contract any external borrowing of less than one year maturity, except for normal trade financing.

9. In support of the measures taken during the first fiscal year (April 1983-March 1984) covered by the program, Malawi requests that the arrangement be amended to allow the purchase of SDR 5 million on observance of the performance criteria for end-March 1984, provided the purchase is made before May 31, 1984.

10. The Government of Malawi believes that the policies described in the medium-term program are adequate to achieve the objectives of the extended arrangement but will take any further measures, in consultation with the Fund, as may be necessary to achieve these objectives. We expect to discuss with a Fund mission in March or April 1984 the details of policies to be implemented in 1984/85, the second year of the program. Malawi will continue to maintain liberal trade and payment policies.

Yours faithfully,

/s/
J.Z.U. Tembo
Governor
Reserve Bank of Malawi

/s/
L. Chakakala Chaziya
Minister of Finance
Government of Malawi

Table I. Malawi: Gross Domestic Product by Economic Activity, 1979-83

	1979	1980	1981	1982	1983 Est.	1980	1981	1982 Est.	1983 Est.	1979	1983
	(In millions of Malawi kwacha)					Growth rates (in percent)				Percentage share in GDP at constant factor cost	
(At 1978 prices)											
Agriculture, forestry, fishing	308.3	291.5	302.1	320.7	331.8	-5.4	3.6	6.2	3.5	39.7	40.2
Estates	(56.2)	(57.7)	(55.1)	(66.9)	(73.9)	(2.7)	(-4.5)	(21.4)	(10.5)	(7.2)	(8.9)
Smallholders	(252.1)	(233.8)	(247.0)	(253.8)	(257.9)	(-7.3)	(5.6)	(2.8)	(1.6)	(32.4)	(31.2)
Manufacturing	90.3	93.6	95.3	89.5	95.3	3.7	1.8	-6.1	6.5	11.6	11.5
Electricity and water	13.7	14.8	14.9	15.5	17.3	8.0	0.7	4.0	11.6	1.8	2.1
Building and construction	48.8	45.3	36.2	35.7	35.7	-7.2	-20.1	-1.4	--	6.3	4.3
Distribution (trade)	109.7	118.0	108.9	108.2	112.8	7.6	-7.7	-0.6	4.3	14.1	13.7
Transport and communications	48.7	50.7	47.3	45.6	47.3	4.1	-6.9	-3.4	3.7	6.3	5.7
Financial services	46.5	44.2	40.9	39.6	41.9	-4.9	-7.5	-3.2	5.8	6.0	5.1
Ownership of dwellings	30.9	31.7	32.3	33.2	34.1	2.6	1.9	2.8	2.7	4.0	4.1
Government services	72.3	77.2	81.0	88.0	88.0	6.8	4.9	8.6	--	9.3	10.7
Social and community services	28.4	28.9	29.8	30.3	30.9	1.8	3.1	1.7	2.0	3.7	3.7
Unallocable finance charge	-20.4	-15.9	-14.6	-9.0	-9.6	--	--	--	--	-2.6	-1.1
GDP at constant factor cost	777.2	780.0	774.0	797.3	825.5	0.4	-0.8	3.0	3.5	100.0	100.0
GDP at constant market prices	851.4	850.9	848.2	873.9	901.0	-0.1	-0.3	3.0	3.1	--	--
(At current prices)											
Indirect taxes less subsidies	83.9	97.2	112.7	127.6	144.4	15.9	15.9	13.6	13.2	--	--
GDP at current market prices	880.7	1,010.9	1,162.9	1,414.5	1,596.5	14.8	14.7	21.7	12.9	--	--
Memorandum item											
Deflator of GDP at market prices (1978=100)	103.4	118.8	137.1	161.9	177.2	14.9	15.4	18.1	9.5	--	--

Sources: Economic Report, 1983; data provided by the Malawian authorities; and staff estimates.

Table II. Malawi: Gross Domestic Product and Expenditure, 1979-86

	1979	1980	1981	1982	1983	1984	1985	1986
	(In millions of Malawi kwacha at current market prices)							
Gross domestic product	880.7	1,010.9	1,162.9	1,414.5	1,596.5	1,801.8	2,023.2	2,266.3
Consumption	749.6	896.2	1,006.9	1,201.2	1,359.6	1,536.1	1,676.9	1,852.8
Smallholders	230.4	268.8	318.8	412.6)				
Other private	355.1	441.1	475.7	566.3)				
Government	164.1	186.3	212.4	222.3)				
Gross fixed capital formation	240.1	259.6	212.2	216.9	255.0	299.1	365.7	439.2
Change in stocks	61.6	-0.4	34.1	73.2	89.4	45.1	48.7	52.3
Exports of goods and nonfactor services	209.7	269.0	294.3	291.2	321.4	365.6	419.8	470.2
Imports of goods and nonfactor services	380.4	413.5	384.6	368.0	428.9	444.2	488.0	548.1
	(As percentages of GDP)							
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Consumption	85.1	88.7	86.6	84.9	85.2	85.3	82.9	81.8
Smallholders	26.2	26.6	27.4	29.2)				
Other private	40.3	43.6	40.9	40.1)				
Government	18.6	18.4	18.3	15.7)				
Gross fixed capital formation	27.3	25.7	18.2	15.3	16.0	16.6	18.1	19.4
Change in stocks	7.0	--	2.9	5.2	5.6	2.5	2.4	2.3
Exports of goods and nonfactor services	23.8	26.6	25.3	20.6	20.1	20.3	20.7	20.7
Imports of goods and nonfactor services	43.2	40.9	33.1	26.0	26.9	24.7	24.1	24.2
Memorandum items:								
Rates of change of:								
GDP at constant market prices	...	-0.1	-0.3	3.0	3.1	3.0	4.0	4.5
GDP deflator	...	14.9	15.4	18.1	9.5	9.6	8.0	7.2

Sources: Economic Report 1983; data provided by the Malawian authorities; and staff estimates.

1/ Includes the value imputed to increases in livestock holdings in the subsistence sector.

Table III. Malawi: Central Government Revenue, 1982/83-1983/84

(In millions of Malawi kwacha)

	1982/83		1983/84		
	Apr.-Nov.	Actual	Apr.-Nov.	Program	Revised
Total revenue	158.8	243.0	188.8	272.9	279.1
Tax revenue	139.6	207.7	165.2	230.5	234.1
Taxes on income and profits	55.4	79.5	69.1	88.4	87.0
Taxes on companies	(32.8)	(45.2)	(42.7)	(48.0)	(48.0)
Taxes on individuals	(22.6)	(34.3)	(26.4)	(40.4)	(39.0)
Taxes on property	0.1	0.1	0.2	0.1	0.2
Taxes on goods and services	48.5	73.8	57.2	83.5	87.1
Surtax	(38.5)	(58.3)	(45.3)	(64.9)	(68.0)
Excises	(7.5)	(11.6)	(8.4)	(12.9)	(14.0)
Licenses	(2.3)	(3.5)	(2.9)	(4.9)	(4.3)
Accommodation and refreshment tax	(0.2)	(0.5)	(0.5)	(0.8)	(0.8)
Taxes on international trade	34.3	52.5	37.7	57.0	58.0
Of which: import duties	(34.3)	(52.5)	(37.7)	(57.0)	(58.0)
Stamp taxes	1.1	1.8	1.0	1.5	1.8
Nontax revenue	19.3	35.4	23.6	42.4	45.0
Departmental receipts	0.4	3.9	0.4	3.1	4.1
Rents	1.5	2.3	1.7	2.9	2.4
Appropriations-in-aid	12.4	26.6	19.9	34.4	31.0
Miscellaneous	4.9	2.7	1.6	2.0	7.5

Sources: Ministry of Finance; and staff estimates.

Table IV. Malawi: Central Government Expenditure, 1982/83-1983/84

(In millions of Malawi kwacha)

	1982/83		1983/84		
	Apr.-Nov.	Actual	Apr.-Nov.	Program	Revised
Total expenditure	212.8	395.7	251.5	419.8	424.7
Recurrent expenditure	151.3	260.7	179.6	272.3	280.2
Expenditure on goods and services	97.3	175.9	113.6	177.4	184.7
Wages and salaries	(39.7)	(68.0)	(45.6)	(78.9)	(77.5)
Other goods and services	(57.6)	(107.9)	(68.1)	(98.5)	(107.2)
Interest	33.5	59.8	43.2	62.3 1/	66.7 1/
Current transfers	20.5	25.0	22.8	31.3 2/	27.5
Other recurrent expenditure	--	--	--	1.3	1.3
Development expenditure	61.5	135.0	71.9	147.5	144.5

Sources: Ministry of Finance; and staff estimates.
1/ Includes debt servicing related to Press reconstruction exercise.
2/ Includes MK 4 million for contribution to support of emergency maize stocks.