

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

**FOR
AGENDA**

EBS/83/27

CONFIDENTIAL

February 3, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Malawi - Staff Report for the 1982 Article IV Consultation
and Review of Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Malawi and a review of the stand-by arrangement for Malawi. Draft decisions appear on pages 20 and 21.

It is proposed to bring this subject, together with Malawi's request for a purchase under the compensatory financing facility (document to be issued), to the agenda for discussion on Monday, February 28, 1983.

Att: (1)

INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the 1982 Article IV Consultation
and Review of Stand-By Arrangement

Prepared by the Staff Representatives for the 1982 Article IV
Consultation with Malawi

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

February 2, 1983

I. Introduction

The 1982 Article IV consultation discussions with Malawi and a review of Malawi's performance under the current one-year stand-by arrangement took place in Lilongwe during the period October 28-November 11, 1982. The staff representatives were Messrs. Edo, Sharer, Greene (all AFR), Mansfield (FAD), and Mrs. Jathoo (secretary-AFR). Mr. Zulu (AFR) participated in part of the discussions, and Mr. Sangare, Executive Director for Malawi, also attended some of the meetings. The Malawi representatives included the Minister of Finance, Mr. Chaziya, the Governor of the Reserve Bank, Mr. Tembo, and senior officials of the Treasury, the Reserve Bank, and other government institutions. Malawi continues to avail itself of the transitional arrangements of Article XIV.

II. Background

For many years up to 1979 Malawi achieved high rates of economic growth without large fiscal and external imbalances. In the ten years that ended in 1979 the average annual real rate of growth was 5.1 per cent, with the rate increasing to 5.9 per cent in the second half of the period. During 1975-79 there was rapid growth in the agricultural and manufacturing sectors. There was particularly rapid expansion in the construction sector as major new projects were undertaken for the construction of the new capital, Lilongwe. Associated with the high rates of activity in these sectors, there was also substantial growth in the distribution, transportation, and service sectors.

During the three fiscal years 1977/78-1979/80 (April-March) the budget deficit as a ratio of GDP averaged about 8 per cent. Revenues and grants increased at an average rate of 28 per cent a year as taxable income rose substantially (with the profitable operations of sugar and tobacco estates) and import duty collections increased (with the large increase in imports). Total expenditures increased by an average of 29 per cent as wage and interest payments increased considerably.

Malawi's external position shows frequent changes, sometimes considerable, from year to year as developments in commodity prices or transport costs (which are significant for Malawi, a landlocked country) affect the current account, and the level of aid inflows affects the capital account. The deficit of the current account of the balance of payments was, on average, moderate in 1975-77 but weakened substantially in 1978 as the trade balance and the net services account both deteriorated; Malawi had substantial recourse to commercial bank borrowing in 1978, and the overall balance of payments deficit was limited to about US\$24 million.

Since 1979 Malawi's economic performance has been less satisfactory. Economic activity has been stagnant, while fiscal and balance of payments imbalances have increased. During the three-year period 1980-82 the investment effort declined, with the ratio of gross capital formation to GDP decreasing from 34 per cent in 1979 to 20 per cent in 1982. Real output showed virtually no growth. Sectoral developments have varied from year to year, but a main factor for the stagnation in output has been the appreciable decline in construction as the major projects in the new capital have been completed. Along with this decrease in construction activity, there have been declines in activity in distribution, transportation and communications, and financial services. Following a reduction in real output in 1980, agriculture has shown moderate rates of growth in 1981 and 1982. Manufacturing, which contributes about 12 per cent of total output, has recorded declining rates of growth and is estimated to have registered a real decrease in output in 1982.

The fiscal position has come under considerable pressure as the rate of growth of receipts has declined appreciably while expenditures have not been correspondingly adjusted. In 1980/81 and in 1981/82 revenues and grants increased by 9 per cent per year, a significant reduction from the average rate of growth of 28 per cent recorded in 1977/78-1979/80. Expenditures, however, increased at a more rapid rate (17 per cent in 1980/81 and 10 per cent in 1981/82). The external position also deteriorated. In terms of GDP, the deficit of the current account of the balance of payments was equivalent to 20 per cent in 1979 and 18 per cent in 1980. The deficit was reduced to 13 per cent of GDP in 1981, but, as net capital inflows declined markedly, the overall position weakened. The cumulative balance of payments deficit in 1979-81 was US\$119.7 million. Net official reserves at the end of 1981 were negative (minus SDR 81 million); gross reserves amounted to SDR 42 million, equivalent to 1.7 months' imports. In the absence of debt relief, Malawi's external debt service ratio would have been 42 per cent in 1982 and 33 per cent in 1983.

With these fiscal and balance of payments developments, Malawi did not fulfill the fiscal and monetary targets of a program covering the two fiscal years 1980/81 and 1981/82, which was supported by a two-year standby arrangement from the Fund. The overall budget deficit in 1980/81 was

equivalent to 11.1 per cent of GDP, compared to a program target of 7.8 per cent, and the increase in net bank credit to the Government was equivalent to 7.3 per cent of GDP, compared to a program target of 0.8 per cent. In 1981/82 the overall budget deficit was equivalent to 10.7 per cent of GDP, compared to a target of 6.8 per cent, and the increase in net bank credit to the Government was equivalent to 8.1 per cent of GDP, compared to a target of no bank financing. As the ceiling on net bank credit to the Government was exceeded in December 1980 and March 1981 and the ceiling on total domestic credit was exceeded in March 1981, a waiver was required at the end of the first year of the two-year arrangement. In the second year the credit ceilings were exceeded in December 1981 and March 1982, and the subceiling on credit to Government was observed in September 1981 only through a short-term financial transaction between the Government and a temporarily liquid statutory corporation; Malawi did not request a purchase scheduled for November 1981, and the purchase scheduled for February 1982 was also not made.

It was against this background that a one-year stand-by arrangement in the amount of SDR 22 million (77 per cent of quota) was negotiated for 1982/83 (April/March), with the objective of restraining demand and containing the domestic and external financial imbalances. Several measures were taken by the authorities to achieve this objective. ^{1/} In April 1982 the Malawi kwacha was devalued by 15 per cent (in local currency terms) with respect to the SDR, to which it is pegged. In July substantial increases (varying from 20 per cent to about 50 per cent) were announced for agricultural producer prices for the 1982/83 growing season. With the aid of measures on both the revenue side and the expenditure side, the deficit in the budget estimates for 1982/83 was to be contained to 7.2 per cent of GDP (compared to an actual deficit in 1981/82 equivalent to 10.7 per cent of GDP). Measures were taken to strengthen the performance of the parastatals, including the appointment of new boards of management and the introduction of more effective financial controls. The Government initiated a program to phase out fertilizer subsidies over three years, and the prices of the products of a number of parastatals (including the Electricity Supply Commission and Air Malawi) were increased.

With the debt service ratio projected to be high in 1982 in the absence of debt relief, the Malawi authorities approached the Paris Club and the commercial banks (London Club) for the rescheduling, respectively, of official debt and commercial bank debt. As the amount of the debt relief could not be reliably estimated at the time the stand-by arrangement was considered by the Executive Board, credit ceilings were specified only for September 1982, and it was provided that the ceilings for December 1982

^{1/} EBS/82/126: "Malawi - Request for Stand-By Arrangement," July 13, 1982.

and March 1983 would be established during the mid-term review, after meetings of the Paris Club and London Club to consider Malawi's request (see Section III.2 for the debt rescheduling agreements).

III. Report on the Discussions

The discussions focused on four main topics: (i) economic performance in 1982, including performance under the stand-by arrangement; (ii) progress with the requests to the Paris and London Clubs for debt rescheduling; (iii) economic prospects; and (iv) the restructuring of parastatals and the major private sector corporation.

1. Economic performance in 1982

Comprehensive statistics on agricultural acreage planted and production are not available for Malawi. Agricultural statistics in Malawi are based on agricultural output marketed by the estates (this comprises virtually the entire production of the estates) and by smallholders (this is smallholder production less consumption on the farm).

Marketed output of maize was considerably higher in 1982 than initially anticipated. Maize purchases by the Agricultural Development and Marketing Corporation (ADMARC) were 260,000 tons, compared to an initial estimate of about 130,000 tons (output in 1981 was 137,000 tons). The increase in production was a result of favorable weather and the substantial increase in ADMARC's producer price (from MK 66 to MK 110 per ton) for the 1981/82 growing season. The large increase in maize output was at the expense of other smallholder crops: the output of fire-cured tobacco, rice, groundnuts and cotton declined. There were, however, increases in the production of crops grown mainly by the estates: sugar, flue-cured and burley tobacco, and tea.

The agricultural sector as a whole is estimated to have grown by about 4 per cent in real terms in 1982, with a particularly strong performance from the estates sector (which constitutes 5 per cent of total agricultural output). GDP, however, is estimated to have registered little change in real terms in 1982, as the growth of the agricultural sector was offset by declines in manufacturing, building and construction, distribution, and transport and communications.

The 1982 auction season for tobacco was a good one, with the unit value of tobacco exports increasing by 35 per cent to MK 3,433 per ton. Price performance was particularly good for fire-cured tobacco. Tea and rice prices also increased appreciably in 1982. However, there were substantial declines in the export prices of sugar, cotton, and groundnuts.

The value of total exports (in U.S. dollar terms) is estimated to have declined by 25 per cent to US\$225 million in 1982 (Table 1). This decline

Table 1. Malawi: Balance of Payments, 1980-83

(In millions of U.S dollars)

	1980	1981	1982		1983
			Prog.	Est.	Proj.
Current account	-217.2	-162.0	-155.3	-140.2	-148.0
Trade balance	-47.5	7.3	-14.6	1.6	5.5
Exports	(294.6)	(299.6)	(247.6)	(224.7)	(275.1)
Imports	(-342.1)	(-292.3)	(-262.1)	(-223.1)	(-269.6)
Net services and unrequited private transfers	-169.7	-169.3	-140.8	-141.7	-153.5
Capital account	222.7	121.4	107.8	77.3	79.0
Government transfers (net)	50.0	48.2	53.4	41.5	40.0
Government borrowing (net)	100.1	37.1	42.7	32.2	35.0
Statutory bodies and Reserve Bank borrowing (net)	12.4	3.4	1.9	0.9	-6.0
Private borrowing (net)	15.3	15.2	-4.9	2.6	--
Short-term capital and errors and omissions	44.9	17.5	14.6	--	10.0
SDR allocation	2.6	--	--	--	--
Overall balance (before debt relief)	8.1	-40.6	-47.6	-62.8	-69.0
Debt relief	--	--	...	17.6	54.0
Balance (after debt relief)	8.1	-40.6	...	-45.2	-15.0
Change in net total reserves (increase in assets -)	-8.1	40.6	...	45.2	15.0
Commercial bank reserves	(-9.5)	(-20.7)	(...)	(--)	(...)
Net IMF position	(27.5)	(27.8)	(...)	(13.5)	(...)
Other official reserves	(-26.2)	(33.5)	(...)	(31.7)	(...)
<u>Memorandum items:</u>					
Current account deficit as per cent of GDP(excluding official transfers)	-17.7	-12.5	-11.8	-10.9	-10.4
Gross official reserves (in months of imports, c.i.f.)	2.0	1.7	...	0.5	0.5

Sources: Reserve Bank of Malawi, Financial and Economic Review; data provided by the Malawi authorities; and staff estimates.

was larger than foreseen under the program, principally because the volume and price of sugar exports were lower than initially forecast. However, there was continued reduction in imports (partly reflecting the cessation of emergency maize imports and of imports related to completed construction projects), and the trade account was in approximate balance. The decline in imports was larger than envisaged under the program because of the adverse impact of the transportation problems on the movement of goods from Mozambican ports. Net service outflows were lower than in 1981 (Table 1), in large part owing to lower transport and insurance costs for imports. As a result, the current account deficit is estimated to have declined in 1982 to 10.9 per cent of GDP, compared with the program target of 11.8 per cent and with a ratio of 12.5 per cent in 1981. However, as in 1981, the decline in the current account deficit was accompanied by a decrease in net capital inflows (associated in part with the reduction in imports for major investment projects), and the overall balance of payments deficit for 1982 is estimated to have amounted, before debt relief, to US\$62.8 million, compared with a program estimate of US\$47.6 million. After debt relief, the deficit in 1982 was US\$45.2 million, compared to US\$40.6 million in 1981. Of the 1982 deficit, about a third was financed through use of Fund resources and the balance through a reduction in gross reserve holdings. Reserve holdings at the end of 1982 were equivalent to about two weeks of imports.

In contrast to the unfavorable experience of the previous two fiscal years, fiscal developments in the first half of 1982/83 were consistent with the program for the fiscal year as a whole. Total revenue and grants amounted to 42 per cent of the total budgeted for the whole year (Table 2), while total expenditure was 40 per cent of the total budgeted for the whole year. The expenditure performance reflected the effectiveness of the expenditure control procedures that were introduced under the program. The deficit in the first half was 35 per cent of the total budgeted for the year. This deficit was financed through the use of external concessional loans, and there was no increase in net bank credit to the Government. The ceiling on net bank credit to the Government was observed in September 1982 (Table 3). Net domestic assets increased in July and August as credit to the statutory bodies rose with the purchase by ADMARC of maize in quantities substantially larger than anticipated. In September the high prices obtained for tobacco enabled the statutory bodies to reduce their credit, and net domestic assets were below the program ceiling.

However, at the time of the mission, the prospects for the second half of the fiscal year were considerably less favorable than developments in the first half. A main cause for this was the severe disruption to transportation routes through Mozambique on which Malawi normally depends for the movement of most of its export and import goods. In a recurrence of the insurgent activity which closed the routes in 1979-80, traffic on the railway lines from Malawi to the Mozambican ports of Beira and Nacala was reduced in August-October 1982 to one third of normal levels. This meant that fuel had to be obtained through Zambia and that fertilizer requirements,

Table 2. Malawi: Central Government Budgetary Operations,
1981/82-1982/83

(In millions of Malawi kwacha)

	Actual	Budget	1st half	Revised projections	
	1981/82	1982/83	actual 1982/83	for 1982/83 Before measures	With new measures
Total revenue and grants	263.2	303.4	126.5	287.3	295.8
Revenue	221.0	248.4	116.2	242.3	250.8
Grants	42.2	55.0	10.3	45.0	45.0
Total expenditure	392.8	401.3	161.0	405.3	394.4
Recurrent	268.6	236.6	105.3	236.6	233.5
Development	124.2	164.7	55.7	155.0	147.2
Extrabudgetary	--	--	--	13.7 <u>1/</u>	13.7 <u>1/</u>
Overall deficit	-129.6	-97.9	-34.5	-118.0	-98.6
Financing	129.6	97.9	34.5	118.0	98.6
Foreign (net)	31.3	49.0 <u>2/</u>	34.3	71.7	71.7
Borrowing	(63.1)	(92.6)	(44.2)	(86.5)	(86.5)
Repayments	(31.8)	(-43.6) <u>2/</u>	(-9.9)	(-14.8) <u>3/</u>	(-14.8) <u>3/</u>
Domestic	98.3	48.9 <u>2/</u>	0.2	46.3	26.9
Of which: banking system	(85.7)	(11.9)	(--)	(45.9)	(26.5)
Deficit as per cent of GDP	10.7	7.0		8.5	7.0

Sources: Financial Statements 1981/82-1982/83; and data provided by the Malawi authorities.

1/ Extrabudgetary expenditure (due to transportation problems) on fuel (MK 5.7 million) and fertilizer (MK 8 million).

2/ These figures are as in the original stand-by paper and do not reflect any adjustment for the original estimate of MK 37 million for debt relief. If adjusted for this estimate, net foreign financing would be MK 86 million, repayments would be MK 6.6 million, and domestic financing would be MK 11.9 million.

3/ Adjusted for debt relief.

Table 3. Malawi: Quantitative Performance Criteria for the 1982/83 Financial Program

	<u>March 1982</u> Actual	<u>June 1982</u> Actual	<u>September 1982</u> Prog. Actual	<u>December 1982</u> Program	<u>March 1983</u> Program	
	(In millions of Malawi kwacha)					
Net domestic assets <u>1/</u>	439.0	459.3	464.1	463.8	488.0	503.7
Net bank credit to the Government <u>2/</u>	197.2	193.8	199.5	193.8	215.0	223.7
	(In millions of U.S. dollars)					
New nonconcessional foreign borrowing contracted or guaranteed with original maturity of 1 to 12 years <u>3/</u>	--	--	10.0	--	10.0	10.0
Of which: with maturity of 1 to 5 years <u>3/</u>	--	--	5.0	--	10.0	10.0

Sources: Data provided by the Malawi authorities; and Annex to EBS/82/126.

1/ Defined as money and quasi-money, long-term liabilities of the Reserve Bank, banking system capital accounts, and SDR allocations, less net foreign assets.

2/ Defined as commercial banks' and Reserve Bank's credit to the Government, less government deposits, plus any use of the local currency counterpart of purchases from the Fund, and external borrowing by the Government for balance of payments support.

3/ To be adjusted upward by a maximum adjustment of US\$3.2 million, if the aircraft currently on lease by Air Malawi is purchased.

vital for the growing season (October-February), had to be obtained from alternative, higher-cost sources. The Malawi representatives estimated that the extrabudgetary costs of acquiring these fuel and fertilizer supplies on an emergency basis would be MK 13.7 million (Table 2). This would consist of additional expenditure of MK 5.7 million on fuel and MK 8.0 million on fertilizer.

On the revenue side, the prospect was that there would be a shortfall of MK 6 million, owing to lower-than-expected repayment of domestic debt owed to Government. The Malawi representatives also thought that grant receipts would be about MK 10 million less than estimated in the budget, which, however, would be offset by an equivalent reduction in development expenditures.

The net effect was that the deficit for the year as a whole was forecast, in the absence of additional measures, to be MK 118 million, compared to MK 98 million in the budget. The revised budget projection for 1982/83 also suggested that there would be a shortfall of MK 6 million in gross foreign inflows, while repayments would be about MK 8 million higher than the budget estimates owing to the fact that the favorable effect of debt rescheduling was not as large in 1982/83 as originally assumed. The combined result of the increase in the projected deficit by MK 20 million and the shortfall in net foreign financing of MK 14 million meant that domestic financing of the budget would, without additional measures, be MK 34 million higher than envisaged in the program.

The Malawi representatives were initially of the view that, since the original budget already reflected a stance of severe restraint and since the adverse developments for the second half of 1982/83 were outside the control of the Government, no new fiscal measures should be required. However, in recognition of the adverse impact of unsustainably large budget deficits, they decided to take the following measures to reduce the actual deficit for the year to the level in the original budget:

- (i) postponement of MK 5.8 million of budgeted education development expenditures;
- (ii) reduction of MK 2 million in government building development expenditures;
- (iii) reduction of MK 3.1 million in current expenditures;
- (iv) increase of MK 2.1 million in company tax collections;
- (v) imposition effective January 1, 1983 of a fuel levy estimated to yield MK 3.0 million;
- (vi) recovery from ADMARC of MK 3.4 million on sales of fertilizer.

For the financing of the budget deficit, the permissible expansion in domestic bank credit to the Government for the fiscal year would be increased by MK 14.6 million to MK 26.5 million. However, this would still amount to less than one third of the net bank credit extended to the Government in 1981/82 (MK 85.7 million). Taking account of these measures, the revised budgetary outcome for the fiscal year would be as shown in the last column of Table 2.

On the basis of these measures, credit ceilings were established for December 1982 and March 1983 (Table 3). Net bank credit to the Government, which amounted to MK 193.8 million at the end of September 1982, is not to exceed MK 215 million at the end of December 1982 or MK 223.7 million at the end of March 1983. The level of net domestic assets, which was MK 463.8 million at the end of September 1982, is not to exceed MK 488 million at the end of December 1982 or MK 503.7 million at the end of March 1983. This means that, for the fiscal year, the increase in net bank credit to the Government will be equivalent to 1.9 per cent of GDP, compared to 0.9 per cent in the original program and to 3.1 per cent in 1981/82, while the increase in net domestic assets will be equivalent to 27.7 per cent of money plus quasi-money at the beginning of the period, compared to 24.4 per cent in the original program and to 46.2 per cent in 1981/82.

Table 4 shows the monetary survey for the fiscal year on the basis of the ceilings specified for December 1982 and March 1983. The rate of monetary expansion for 1982/83 is targeted to be 17 per cent, compared to 15 per cent in 1981/82. Provision is made for credit to the private sector to increase by 15 per cent; one of the objectives of the program is to encourage private sector activity by permitting a rate of increase of credit to the private sector larger than the average of 8 per cent a year recorded in 1980/81 and 1981/82. Statutory bodies are expected to have relatively little recourse to bank credit, as they are expected to improve their financial performance through better management and appropriate pricing policies. As shown in Table 4, actual statistics for October and November 1982 are consistent with the ceilings for December 1982 established at the time of the mission in early November (actual data for December 1982 are expected to be available before the end of January 1983).

The rate of increase of the consumer price index, which had risen to high levels in 1980 (18 per cent for the low-income group and 27 per cent for the high-income group), declined substantially to about 10 per cent for each index in 1981 as the food and fuel shortages of 1980 were alleviated. The rate of consumer price increase showed a further slight decline in the first six months of 1982, but some rise was expected in the second half of the year on account of the fuel shortage, and the rate of price increase for the year as a whole is provisionally estimated at 11 per cent.

There have been no changes in interest rates since increases were introduced at the beginning of 1980 as part of the measures adopted to contain

Table 4. Malawi: Monetary Survey, March 1981-March 1983

(In millions of Malawi kwacha)

	1981	1982					1983	
	<u>March</u> Actual	<u>March</u> Actual	<u>June</u> Actual	<u>Sept.</u> Actual	<u>Oct.</u> Actual	<u>Nov.</u> Actual	<u>Dec.</u> Ceiling	<u>March</u> Ceiling
Foreign assets (net)	-86.8	-137.8	-124.6	-131.2	-138.9	-147.0	-147.0	-185.0
Net domestic assets	345.0	439.0	459.3	463.8	470.5	470.9	488.0 1/	503.7 1/
Credit to the Government	115.3	197.2	193.8	193.8	200.1	198.9	215.0 1/	223.7 1/
Credit to statutory bodies	58.3	56.9	60.7	61.1	65.6	63.6	60.0	59.5
Credit to private sector	182.7	208.4	222.6	228.3	225.8	233.2	233.0	240.5
Other assets (net)	-11.3	-23.5	-17.8	-19.4	-21.0	-24.9	-20.0	-20.0
Capital, reserves, SDR allocation, and long-term liabilities	54.9	66.9	49.8	41.8	44.2	44.6	45.0	45.0
Money and quasi-money	203.3	234.0	285.0	290.8	287.4	279.3	296.0	273.7

Sources: Reserve Bank of Malawi, Financial and Economic Review, and data provided by the Malawian authorities.

1/ Performance criteria.

domestic demand. The bank rate is 10 per cent, the maximum commercial bank lending rate is 18.5 per cent, and the rates on savings deposits and time deposits are, respectively, 8.75 per cent and 11.75 per cent. These rates are generally positive in real terms, and it is the view of the authorities that no changes in interest rates are required at this time. The mission noted the wide spread between savings and lending rates; the commercial banks stated that most lending was made at 13-14 per cent (and not at the maximum lending rate of 18.5 per cent) and that the spread was needed to provide for bad debts.

The Malawi kwacha has been pegged to the SDR since June 1975. The real import-weighted effective exchange rate index of the kwacha fluctuated considerably from 1975 to 1978 but moved within a narrow band between January 1979 and September 1980. From October 1980 to March 1982, the real rate appreciated by 11 per cent in response to the strengthening of the SDR during the period, particularly with respect to the South African rand which has an important weight in the import index. On April 24, 1982, the kwacha was devalued by 15 per cent in local currency terms to the current rate of MK 1 = SDR 0.8250. The devaluation, and the subsequent increase in producer prices, contributed to an increase in marketed output and to some improvement in the financial position of ADMARC. Since the devaluation in April, the real effective rate is estimated to have appreciated slightly (by 1 per cent).

Malawi does not maintain any restrictions on payments and transfers for current international transactions. Import licenses are required for purchases from all countries that are not members of the GATT, and for purchases of a small range of goods (comprising about 3 per cent of imports in 1980) regardless of the country of origin. Applications for foreign exchange for import payments are referred to the exchange control authorities for formal approval subject only to the presentation of relevant import documents. Malawi does not have any arrears on international payments.

2. External debt rescheduling

Malawi's request for external debt rescheduling was caused by the concentration of debt service payments in the years 1982-85 and by the weak balance of payments position. Malawi had borrowed substantially on commercial terms beginning in 1978 to finance urban and infrastructural facilities as well as agricultural projects. The urban and infrastructural facilities have low financial returns, while the agricultural projects have been adversely affected by low international commodity prices. The major recipients of foreign loans in Malawi have been the Government, the statutory bodies, and the Press Trust (the largest private sector concern). With the increasing recourse to commercial debt, Malawi's total debt (public and publicly guaranteed) increased by 43 per cent in 1979, 29 per cent in 1980, and 17 per cent in 1981. The share in total debt of borrowing from financial institutions rose from 2 per cent in 1976 to 21 per cent in 1981. The debt service ratio increased from 12 per cent in 1978 to 26 per cent in 1981

and, without rescheduling, would have been 42 per cent in 1982 and 35 per cent in 1983. The stock of debt at the beginning of 1982 was US\$774 million, equivalent to 64 per cent of GDP.

The Paris Club agreed in August 1982 to reschedule 85 per cent of Malawi's principal and interest due between July 1982 and June 1983, with payments to be made in ten semiannual installments after three and a half years' grace. 1/ The remaining 15 per cent is to be paid half according to the original schedule and half in June 1984. Interest rates are to be negotiated bilaterally not later than March 31, 1983. The Paris Club agreed to consider at a later date the rescheduling of principal and interest falling due between July 1983 and June 1984. Agreement with commercial bank creditors (the London Club) was reached in principle in November 1982 to reschedule 85 per cent of principal due in the year beginning September 1, 1982, with payment to be made after three years of grace in seven semiannual installments. The interest rate on the rescheduled amount is $1 \frac{7}{8}$ per cent over LIBOR, and there is a rescheduling fee of $2 \frac{1}{8}$ per cent. All original interest payments and the remaining 15 per cent of original principal is to be paid according to the original schedule. The banks offer similar terms for debt falling due during the year beginning September 1, 1983 provided Malawi continues to meet the requirements of a Fund program and an IBRD structural adjustment loan, and provided the Paris Club agrees to reschedule debt falling due after June 1983. The Commonwealth Development Corporation (which is not covered by the Paris Club and accounts for about 8 per cent of Malawi's original debt service payments) has made separate proposals for relief.

On the basis of the above proposals, the mission calculated that Malawi's debt relief will amount in 1982 to US\$17.6 million (which reduces the debt service ratio from 42 per cent to 35 per cent) 2/ and in 1983 to US\$54 million (which reduces the debt service ratio from 35 per cent to 17 per cent). 3/ The amount of relief is somewhat smaller than assumed in the stand-by arrangement because the London Club rescheduling begins later than had been envisaged (September instead of July) and is on somewhat harder terms than anticipated. 4/

Table 5 shows Malawi's current and projected debt service payments in 1981-87 without relief and after relief. The debt service payments in the

1/ See SM/82/208, "Report on Malawi's External Debt Renegotiation", October 26, 1982.

2/ Or from 50 per cent to 43 per cent if Fund charges and repurchases are included (Table 5).

3/ Or from 41 per cent to 24 per cent if Fund charges and repurchases are included (Table 5).

4/ The program initially assumed that debt relief would amount to US\$27.7 million in 1982 and US\$66.2 million in 1983.

Table 5. Malawi: Current and Projected Debt Service Payments, 1981-87 1/

(In millions of U.S. dollars)

	1981	1982	1983	1984	1985	1986	1987
<u>Debt service (without relief)</u>							
Principal	45.9	83.0	75.6	84.5	78.7	67.2	54.4
Interest	54.4	54.3	51.1	49.2	48.6	48.9	49.6
Total	<u>100.3</u>	<u>137.3</u>	<u>126.7</u>	<u>133.7</u>	<u>127.3</u>	<u>116.1</u>	<u>104.0</u>
Of which: Fund charges and repurchases	(11.6)	(22.8)	(20.0)	(33.3)	(41.1)	(35.9)	(35.4)
<u>Debt service (after relief) <u>2/</u></u>							
Principal	45.9	66.3	26.0	55.0	81.0	77.5	75.3
Interest	54.4	53.4	46.7	57.6	62.6	63.8	63.2
Total	<u>100.3</u>	<u>119.7</u>	<u>72.7</u>	<u>112.6</u>	<u>143.6</u>	<u>141.3</u>	<u>138.5</u>
<u>Debt service ratio <u>3/</u></u>							
Without debt relief	29.3	49.7	40.2	40.8	35.1	29.0	23.6
After debt relief	29.3	43.3	23.0	34.3	39.6	35.3	31.4
<u>Memorandum item:</u>							
Exports of goods and nonfactor services	342.4	276.2	315.5	327.8	362.3	399.8	440.9

Sources: IBRD Statistical Services Division; data provided by the Malawi authorities and staff estimates.

1/ Based on current debt and the current level of Fund commitments and, in addition, the servicing of new projected borrowings and use of Fund resources in 1983-87.

2/ Provisional; assumes the rescheduling of debt falling due in 1982/83 and 1983/84 on the terms described in the text.

3/ As per cent of exports of goods and nonfactor services.

table are based on debt currently outstanding and the current level of Fund commitments, as well as the servicing of new projected borrowings and use of Fund resources in 1983-87. The projections assume that the Paris Club will reschedule debt falling due in July 1983-June 1984 on the same terms as debt falling due in July 1982-June 1983 and that the London Club will reschedule debt falling due in September 1983-August 1984 on the same terms as debt falling due in September 1982-August 1983. As shown by the table, the debt relief exercise reduces the debt service burden in 1983 and 1984 but the debt service ratio is projected to increase to 35.7 per cent in 1985 before declining to 28 per cent in 1987.

3. Economic prospects

As a land-locked, predominantly agricultural country, Malawi's economic performance is heavily dependent on the weather, world prices for agricultural commodities, and the functioning of the transportation routes through Mozambique to ports on the Indian Ocean. At the time of the consultation discussions in early November, it seemed that the disruption of the rail routes in Mozambique would cause critical shortages in fertilizer and fuel supplies for use in the growing season (October-February). An IBRD mission which returned from Malawi in December has reported that the fertilizer supplies which had been received or were expected amounted, in conjunction with stocks carried over from the previous year, to about 90 per cent of basic requirements. The 10 per cent shortfall will nevertheless affect output, and there were probably delays in the application of the fertilizer. The fuel shortage remains severe and has been aggravated by the destruction in December of fuel depots in the Mozambican port of Beira.

The rains appear to be normal so far, but agricultural production may show little increase in 1983 on account of the delays in fertilizer application. The transportation problems will affect the supply of imported inputs to the small manufacturing sector, which is expected to continue to stagnate. With activity reduced in the construction and other sectors, the likelihood is that the real rate of growth of GDP will remain low in 1983.

The balance of payments is projected to remain under pressure in 1983, though the overall position will benefit from the impact of the debt relief (Table 1). Exports are projected to increase by 22 per cent to US\$275 million (from US\$225 million in 1982), principally because of increases in the volumes of exports of tobacco and groundnuts (prices are assumed to remain at about the same levels as in 1982). The increases in the value of tobacco and groundnut exports are projected to exceed a continuing decline in sugar exports. Imports (f.o.b.) are projected to increase by 21 per cent in 1983 to US\$270 million; even so, this would be, except for 1982, the lowest level of imports since 1978. The trade account is projected to remain in approximate balance; with the traditional deficit on net services and private unrequited transfers, the current account deficit is projected to be 10.4 per cent of GDP (compared to 10.9 per cent in 1982). The overall deficit before relief (US\$69 million) will be slightly larger than in 1982 but after debt relief will be US\$15 million, compared to US\$45 million in 1982.

Tentative medium term balance of payments projections prepared by the staff indicate that the current account deficit will decline by 1987 to a level that, on the basis of Malawi's previous experience, can be financed on a sustainable level by predominantly concessional inflows. These projections, however, assume that appropriate policies will continue to be applied by the authorities and that the rate of growth of imports will be restrained. These projections will be reviewed by the staff with the Malawi authorities during the forthcoming discussions (tentatively scheduled for early March) on a new program.

The fiscal position is projected to continue to be difficult in 1983/84. Revenue and grants are projected to increase by only about 11 per cent (on the basis of measures currently under consideration). This would mean that expenditures can increase in nominal terms by no more than 7 per cent if the ratio of the budget deficit to GDP is to show a decrease. The tax base in Malawi is narrow and shows little increase when agricultural incomes are stagnant and imports decline. The staff and the Malawi authorities are reexamining possible new revenue measures for 1983/84, including increases in the surtax on imports and domestic manufactures, and increases in rents for government housing.

4. Statutory bodies and private sector enterprises

During the commodity price boom of the mid-1970s the private sector and the statutory bodies in Malawi performed satisfactorily. The enterprises were profitable, employment expanded, and several new projects were initiated. However, the rapid expansion of activity put heavy strains on the limited supply of managerial personnel, and efficiency declined. Also, much of the expansion in activity was financed through borrowing. As the stock of debt rose and international interest rates increased substantially, the financial position of many of the enterprises deteriorated significantly.

Concerned by the nonperformance of some of their loans to agricultural estates, the two domestic commercial banks in 1980 significantly reduced their lending to agriculture and foreclosed on some loans. The banks took active measures to provide technical and financial management to the weaker tobacco estates. With the increases in tobacco prices in 1981 and 1982, the tobacco estates have been able to resume normal servicing of their domestic debt.

However, the financial positions of ADMARC, the Government's wholly-owned Malawi Development Corporation (MDC), and Press Trust (a large private sector conglomerate which accounts for 10 per cent of total employment in Malawi) have remained weak owing to management or organizational inadequacies, large foreign liabilities, or faulty investment strategy. Several of the investments of these corporations (especially in sugar, manufacturing, and distribution) have sustained substantial losses.

The reorganization of these corporations is an important part of Malawi's adjustment policies under the stabilization program. Already new

boards of directors and new chief executives have been appointed, and efforts are being made to recruit suitable financial management and to institute effective accounting procedures. The restructuring of the external debt of these corporations is part of the agreement between Malawi and the Paris and London Clubs on the rescheduling of government-guaranteed debt.

The authorities are aware that the measures already taken will need to be supplemented in future by further measures to strengthen the operations of unprofitable subsidiaries and restore financial discipline. Policies will also be required to attract new investment capital (foreign and domestic). The authorities have studied the recommendations of consultant groups commissioned to examine these issues and expect to introduce new measures soon.

IV. Staff Appraisal

For several years up to the late 1970s, the performance of the Malawi economy was relatively satisfactory. The authorities pursued pragmatic and prudent policies, emphasized the development of agriculture, and achieved self-sufficiency in basic foodstuffs. The real rate of economic growth was high, and the fiscal and balance of payments imbalances were relatively small.

Since 1979 a combination of events has caused a marked deterioration in the economic situation. Droughts in two successive years led to the temporary importation of maize in 1981. Periodic interruptions (by insurgent activity) of the rail and surface routes through Mozambique, on which Malawi depends for access to Indian Ocean ports, have impeded the movements of import and export goods, considerably increased the cost of imports, and led to shortages of fuel, fertilizer, and other imports. The 1979 oil price increase and the declines in agricultural export commodity prices have resulted in a substantial deterioration in Malawi's terms of trade. Government expenditures were high as the authorities substantially increased development outlays, especially for infrastructure and for the development of the new capital, Lilongwe. The Government, and corporations engaged in production activities, contracted large amounts of external debt to finance development and expansion projects, and the financial position of the corporations declined as commodity prices were reduced and interest rates on foreign debt increased. As a result of these developments, Malawi's fiscal and balance of payments imbalances have been large, and the debt burden has significantly increased.

In order to deal with this situation, Malawi adopted an adjustment program for 1982/83 (April-March) supported by a one-year stand-by arrangement, approved by the Board on August 6, 1982, in an amount equivalent to SDR 22 million (77 per cent of quota). Under this program the authorities adopted a budget for 1982/83 with a substantially lower deficit than in

1981/82, devalued the currency in April, and increased several producer prices for the 1982/83 growing season. Measures have also been taken to improve the management of statutory bodies, and Malawi reached agreement with the Paris Club in August 1982 and with the London Club in November 1982 on the rescheduling of debt.

As of the end of September 1982, the end of the first half of the current fiscal year, fiscal developments were in accordance with the program, and all performance criteria stipulated in the stand-by arrangement were observed. The exchange rate action of April and the increases of producer prices have had a beneficial impact on marketed output: the output of maize was substantially larger than in the previous year, and the production of estate crops increased. Interest rates are currently positive in real terms and there is no need for changes in interest rates at the present time. Following the devaluation of the currency in April 1982, the new exchange rate has provided appropriate incentives for production and trade and contributed to the improvement of the financial position of the agricultural marketing agency. Since the devaluation, the real effective exchange rate has shown little change.

The Malawi authorities have adopted new fiscal measures to ensure that the budget deficit will be kept within the limit in the program, even though transportation problems have led to extrabudgetary expenditures for the purchase of emergency supplies of fuel and fertilizer. The staff believes that, with the measures taken, Malawi should be able to observe the quantitative performance criteria during the remaining period of the arrangement.

Provisional balance of payments results for 1982 were consistent with the targets of the stand-by program. However, the balance of payments position is expected to remain under pressure in 1983 and imports will need to be restrained over several years to reduce the current account deficit to a sustainable level in the medium-term. The staff will review the balance of payments outlook and discuss required adjustment policies with the authorities in a forthcoming mission tentatively scheduled for early March 1983.

Beyond the current fiscal year, there are several important issues that will need to be addressed. Price developments of the recent past have shown that the Malawi economy remains narrowly based, even with the successful diversification into sugar since the late 1970s. Attention will therefore need to be devoted to improvements in the efficiency of production and to further export diversification. A study of the fiscal system is required, to improve the yield of present tax measures and to identify possible new sources of budgetary revenue; without higher increases in revenue than those recorded in the last few years, the scope for expenditure increase in the future will be severely limited. A study will need to be made of possible alternative transportation routes to reduce Malawi's dependence on the vulnerable rail and road routes through Mozambique. Malawi will have to maintain appropriate wage, pricing, and interest rate

and exchange rate policies to restrain demand, encourage output and exports, and promote domestic savings. The Malawi authorities recognize these problems. They are currently discussing a proposed SAL arrangement with the World Bank and have requested an EFF arrangement to succeed the current stand-by arrangement.

The staff welcomes Malawi's continued maintenance of a liberal trade system and an exchange system which is free of restrictions on payments and transfers for current international transactions.

V. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

Article IV Consultation

1. The Fund takes this decision in concluding the 1982 Article XIV consultation with Malawi in the light of the 1982 Article IV consultation with Malawi conducted under Decision No. 5392 - (77/63) adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. The Fund notes with satisfaction that Malawi continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

Review Under Stand-By Arrangement

1. Malawi has consulted with the Fund in accordance with paragraph 4(b) of the stand-by arrangement for Malawi and paragraph 3 of the letter from the Minister of Finance of Malawi, dated June 11, 1982, attached to the stand-by arrangement for Malawi (EBS/82/126, Supplement 1), and in order to review progress under the program and reach understandings with the Fund regarding policies and measures that Malawi will pursue during the remaining period of the stand-by arrangement.

2. The letter from the Minister of Finance of Malawi dated January 24, 1983 shall be annexed to the stand-by arrangement for Malawi, and the letter of June 11, 1982 shall be read as supplemented by the letter of January 24, 1983. Accordingly, the understandings referred to in paragraph 4(b) of the stand-by arrangement for Malawi relating to domestic assets of the banking system and net bank credit to the Government shall be those described in

paragraph 4 of the attached letter of January 24, 1983. Moreover, with respect to exchange rate policies, the Fund finds that no further understandings are necessary.

MALAWI - Relations with the Fund
(As of December 31, 1982)

Date of membership: July 19, 1965

Status: Article XIV

Quota: SDR 28.5 million

Exchange rate system: The Malawi kwacha is pegged to the SDR; since the devaluation of April 24, 1982, the rate has been MK 1.0 = SDR 0.8250.

Fund holdings of Malawi kwacha:	<u>Millions of SDRs</u>	<u>Per cent of quota</u>
Total	102.1	358.2
Under tranche policy	53.2	186.6
From ordinary resources	25.1	87.9
From supplementary financing facility	28.1	98.7
Under oil facility	0.2	0.6
Under compensatory financing facilities	19.3	67.8
For exports	17.8	62.5
For cereals	1.5	5.3
Under buffer stock financing facility	0.9	3.2

SDR Department:	<u>Millions of SDRs</u>	<u>Per cent of allocation</u>
Net cumulative allocation	11.0	100.0
Holdings	3.6	32.7

Trust Fund: Malawi has received loans of SDR 6.2 million during the first period and SDR 8.4 million during the second period.

Direct distribution of profits from gold sales: Malawi has received US\$2.4 million.

Gold distribution: 12,837 ounces of fine gold

Recent contacts

Staff discussions for the last Article IV consultation were held February 9-23, 1981. The staff report (SM/81/96) was discussed by the Executive Board on May 13, 1981. A stand-by arrangement in support of a

MALAWI - Relations with the Fund (concluded)

financial and economic program for the period end-March 1980 through end-March 1982 was approved by the Board on May 13, 1981 at the same time as a request for waiver of performance criteria for the end of the first year. The stand-by arrangement was reviewed during a staff visit from October 28 to November 6, 1981. Negotiations for a one-year stand-by arrangement took place during staff visits from February 4 to 17, 1982 and from May 8 to 20, 1982, and the stand-by was approved by the Executive Board on August 6, 1982 (EBS/82/126) and reviewed during the Article IV consultations held during October 28-November 11, 1982. In addition, a sugar buffer stock financing facility for SDR 0.922 million was approved by the Executive Board on December 6, 1982 (EBS/82/201).

MALAWI - Relations with the World Bank Group

Over the last 16 years, the World Bank Group has granted Malawi 24 IDA credits totaling US\$271 million and 6 World Bank loans totaling US\$75 million, of which 2 were on third-window terms. Of the entire funds committed, US\$105 million (31 per cent) were for agricultural projects, US\$74 million (22 per cent) for education, US\$65 million (19 per cent) for roads, US\$45 million (13 per cent) for structural adjustment, US\$38 million (11 per cent) for power projects, US\$3 million (1 per cent) for development finance companies, and the remainder for a combination of projects including water supply development, technical assistance, and financing feasibility studies for a pulp and paper mill at Viphya. In addition, between 1976 and 1980 the IFC provided US\$20.4 million in funding, of which US\$19.6 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.

Malawi's first Bank loan was approved in June 1976, on third-window terms, and its first standard Bank loan was approved in April 1977. Thus far, Malawi has had an excellent disbursement record, on average disbursing up to 85 per cent of the Bank funds it has received.

The Bank's most recent commitment to Malawi, signed in September 1982, was an SDR 3.6 million (US\$4 million equivalent) engineering credit to the Lilongwe water board to finance master plan studies, determine an optimal long-term program for water and sanitation facilities, and identify further desirable water supply projects.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15

MALAWI--Basic Data

Area, population, and GDP per capita

Area	118,500 square kilometers
Population: Total (1982)	6.2 million
Growth rate	2.9 per cent
GDP per capita (1981)	SDR 170

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
	(In millions of Malawi kwacha)				
<u>Gross domestic product at constant 1978 factor cost</u>	<u>737.4</u>	<u>777.2</u>	<u>780.0</u>	<u>774.0</u>	<u>783.0</u>
Agriculture	284.9	308.3	291.5	302.1	313.8
Manufacturing	84.8	90.3	93.6	95.3	91.1
Electricity and water	12.5	13.7	14.8	14.9	15.3
Building and construction	46.2	48.8	45.3	36.2	33.9
Transport and communications	44.7	48.7	50.7	47.3	43.2
Distribution (trade)	104.8	109.7	118.0	108.9	106.8
Financial services and other	55.4	57.0	60.0	58.6	62.1
Government and social services	94.1	100.7	106.1	110.8	116.9
<u>GDP at current market prices</u>	<u>785.6</u>	<u>880.7</u>	<u>1,010.9</u>	<u>1,162.9</u>	<u>1,355.7</u>
Domestic expenditure	937.0	1,051.3	1,155.4	1,253.2	1,440.3
Private consumption	(503.7)	(585.5)	(709.9)	(794.5)	(945.5)
Public consumption	(134.2)	(164.1)	(186.3)	(212.4)	(217.7)
Gross capital formation	(299.1)	(301.7)	(259.2)	(246.3)	(277.1)
Exports of goods and nonfactor services	185.7	209.7	269.0	284.3	276.2
Imports of goods and nonfactor services	327.1	380.3	413.5	384.6	360.8
<u>Government finance 1/</u>					
Revenue and grants	174.6	221.6	242.5	263.2	303.4
Recurrent expenditure	134.5	177.9	183.7	268.6	236.6
Development expenditure	113.5	127.9	174.9	124.2	164.7
Overall deficit	-73.4	-84.2	-116.1	-129.6	-97.9
Financing	73.4	84.2	116.1	126.6	97.9
Foreign (net)	61.8	71.0	40.0	31.3	49.0
Domestic (net)	11.6	13.2	76.1	98.3	48.9
Of which:					
banking system	(10.9)	(22.8)	(48.1)	(85.7)	(11.9)

1/ Fiscal year (April-March). Data from 1978-81 are actuals; for 1982, budget data are given.

MALAWI--Basic Data (concluded)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
	(In millions of Malawi kwacha)				
<u>Money and credit (end of period)</u> ^{1/2}					
Foreign assets (net)	-90.1	-80.2	-73.6	-99.3	-131.2
Domestic credit	219.6	292.5	324.3	421.6	483.2
Claims on Government (net)	46.6	65.4	83.4	167.8	193.8
Claims on statutory corporations	50.7	56.4	58.5	62.0	61.1
Claims on private sector	122.3	170.7	182.4	191.8	228.3
Money and quasi-money	168.6	170.1	191.5	241.4	290.8
<u>Prices</u>					
GDP deflator (1978 = 100)	100.0	102.5	117.1	135.7	156.8
Blantyre low-income index ^{2/} (1970 = 100)	185.2	206.1	243.9	267.2	281.8
Export-price index (1978 = 100)	100.0	88.9	87.4	110.0	145.4
Import-price index (1978 = 100)	100.0	116.7	140.8	154.7	177.9
Terms of trade (1978 = 100)	100.0	76.2	62.1	71.1	81.7

(In millions of SDRs)

<u>Balance of payments</u>					
Exports, f.o.b.	147.4	172.2	226.3	254.1	203.4
Imports, f.o.b.	-212.2	-240.1	-262.8	-247.9	-202.0
Trade balance	-64.8	-69.9	-36.5	6.2	1.4
Services	-83.2	-98.8	-125.4	-142.3	-126.5
Unrequited private transfers (net)	34.8	35.9	33.4	39.6	35.8
Current account balance	-113.2	-132.8	-128.5	-96.5	-89.3
Capital account (including net errors and omissions)	94.5	61.3	134.7	62.1	48.4
Overall balance (deficit -)	-18.7	-67.5	6.2	-34.4	-40.9
<u>Gross official foreign reserves</u>	57.8	48.9	56.1	42.2	12.9 ^{1/}

(In millions of U.S. dollars)

<u>Outstanding external debt</u>	359.6	514.7	664.5	774.2	784.0
----------------------------------	-------	-------	-------	-------	-------

^{1/} 1982 data are for end-September.

^{2/} 1982 data are for end-June.

Malawi: Selected Economic and Financial Indicators, 1980-83

	1980	1981	1982		1983
	Actual	Actual	Prog. 1/	Est.	Est.
(Annual per cent changes, unless otherwise specified)					
National income					
GDP at constant factor cost	0.4	-0.8	1.8	1.2	2.0
GDP deflator	14.2	15.9	13.8	15.5	13.0
Consumer prices	18.3	9.6	9.0	10.9	12.0
External sector					
Exports, f.o.b.					
(millions of US\$)	294.6	299.6	247.6	224.7	275.1
Imports, c.i.f.					
(millions of US\$)	438.6	374.7	338.6	288.2	345.6
Non-oil imports, c.i.f.					
(millions of US\$)	387.4	314.1	...	242.8	291.2
Export volume	30.0	-11.5	3.0	-11.1	20.2
Import volume	-9.2	-17.8	-2.5	-18.9	14.2
Terms of trade (deterioration -)	-18.5	14.5	-4.6	-5.2	-3.0
Nominal effective exchange rate, year-end					
(depreciation -)	-9.2	10.2	...	-7.6	...
Real effective exchange rate					
(depreciation -)	-4.4	5.0	...	-8.9	...
Government budget 2/					
Revenue, including grants	9.4	8.5	15.3	12.4	13.3
Total expenditure	17.3	9.5	2.2	0.4	11.6
Money and credit 2/					
Domestic assets increase 3/	32.0	46.0	36.3	27.8	20.4
Credit to government increase 3/	28.9	42.2	20.9	9.7	5.1
Money and quasi-money (M ₂)					
increase 3/	22.0	15.1	15.0	17.0	15.7
Velocity (GDP relative to M ₂)	5.2	5.2	5.2	5.3	5.1
Interest rate (annual rate, one-year savings deposits)	8.75	8.75	8.75	8.75	8.75
(In per cent of GDP)					
Central government budget					
deficit 2/					
Excluding official transfers	15.8	14.8	11.3	10.5	8.7
Including official transfers	11.1	10.7	7.0	7.0	6.0
Domestic bank financing 2/	7.3	8.1	3.5	2.9	1.0
Foreign financing 2/	3.8	2.6	3.5	5.1	5.0
Gross domestic investment	25.6	21.2	17.2	20.4	19.5
Gross national savings	7.2	9.3	10.0	9.5	8.5
Current account deficit					
Excluding official transfers	17.7	12.5	11.8	10.9	10.4
Including official transfers	13.7	8.8	7.7	7.7	7.6
External debt, January 1 (inclusive of use of Fund credit) (in millions of US\$)	514.7	664.5	777.0	774.2	824.5
Debt service ratio 4/					
Pre-debt rescheduling	18.7	29.3	43.5	49.7	38.8
Post-debt rescheduling	18.7	29.3	37.1	43.3	21.7
Interest payments 4/	19.0	18.8	19.6	19.7	14.9
(In millions of U.S. dollars, unless otherwise specified)					
Overall balance of payments	8.1	-40.6	-47.6	-45.2	-15.0
Gross official reserves (months of imports, c.i.f.)	2.0	1.7	1.5	0.5	0.5
External payments arrears	--	--	--	--	--

1/ Monetary and balance of payments data are before taking account of debt relief.

2/ Fiscal year beginning April 1.

3/ As a percentage of money and quasi-money at the beginning of the period.

4/ In per cent of exports of goods and nonfactor services. Based on data provided to the IBRD and including IMF charges and repurchases.

Lilongwe, January 24, 1983

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

Dear Mr. de Larosière,

1. Under the stand-by arrangement approved on August 6, 1982, the Government of Malawi undertook to hold consultations with the Fund on the progress of the program, and to agree on exchange rate policies and on the credit ceilings for December 31, 1982 and March 31, 1983. For this purpose, an IMF mission was in Lilongwe on October 28-November 11, 1982 to review progress during the first half of the current fiscal year, 1982/83 (April-March) and the outlook for the rest of the year.

2. The fiscal performance in the first half of the year has been in accordance with the objectives of the program. All quantitative performance criteria have been observed as of the end of September 1982.

3. The outlook for the second half is difficult on account of severe disruptions to our transportation routes through Mozambique, which have impeded the movement of our export and import goods. Fuel and fertilizer supplies already ordered have been stranded in Mozambican ports, and we have had to incur extrabudgetary expenditures for emergency supplies from alternative, higher-cost sources. Notwithstanding this adverse development, we are determined that the budget deficit for the year shall not exceed the target in the program, and, even though the program budget already involved severe restraint, we are taking further measures. We are reducing budgeted

expenditures in the following categories: education (MK 5.8 million), government buildings (MK 2.0 million), current expenditures (MK 3.1 million); and we are increasing receipts through increased company tax collections (MK 2.1 million), recoveries on fuel expenditures (MK 3.0 million), and recoveries on fertilizer expenditures (MK 3.4 million). The recoveries on fuel expenditures will be achieved by a fuel levy which was introduced on January 1, 1983 and the recoveries on fertilizer sales will be from the receipts of sales of fertilizer by ADMARC.

4. Consistent with the observance of the program's budget deficit target, we reached understandings with the mission on credit targets for December 31, 1982 and March 31, 1983. The net domestic assets of the banking system, which were MK 463.8 million at the end of September 1982, will not exceed MK 488.0 million on December 31, 1982 or MK 503.7 million on March 31, 1983. Net bank credit to Government, which was MK 193.8 million at the end of September 1982, will not exceed MK 215.0 million on December 31, 1982 or MK 223.7 million on March 31, 1983.

5. The exchange rate action of April 1982 had, as anticipated, a net negative impact on the budget due to the increase in the domestic currency value of foreign debt service. However, the action made it possible to increase agricultural producer prices substantially, and output response has been favorable. For the present, no change in policy is required, but the issue will be kept under review.

6. With low export prices for our products and difficulties with the transportation routes through Mozambique, the immediate economic outlook is difficult. We are, however, resolved to maintain the stabilization effort,

to seek diversification of transport routes, and to improve the efficiency of production of the agricultural sector. These objectives can be realized only in the medium term, and we request that the current stand-by arrangement be succeeded by an extended arrangement with the Fund.

Yours faithfully,

/s/

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

/s/

L. Chakakala Chaziya
Minister of Finance
Government of Malawi