FOR
AGENDA

EBS/88/25

CONFIDENTIAL

February 9, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Malawi - Staff Report for the 1987 Article IV Consultation and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with Malawi and its request for a stand-by arrangement equivalent to SDR 13.02 million, which will be brought to the agenda for discussion on a date to be announced. Draft decisions appear on pages 32 and 33.

Mr. Edo (ext. 8752) or Mr. Sharer (ext. 6515) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the 1987 Article IV Consultation and Request for Stand-By Arrangement

Prepared by the African Department and the Exchange and Trade Relations Department

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

Approved by A.D. Ouattara and S. Anjaria

February 8, 1988

Contents

I. Introduction

The 1987 Article IV consultation discussions with Malawi, together with discussions on an economic and financial program that could be supported by the use of Fund resources, took place in Lilongwe and Blantyre during November 12-28, 1987. Preliminary discussions on a policy framework paper covering the three-year period 1988/89-1990/91 were also held. The Malawian representatives included Mr. L.J. Chimango, of the Reserve Bank of Malawi; Mr. J. Malewezi, Secretary of the Treasury; Mr. F.Z. Pelekamoyo, General Manager of the Reserve Bank of Malawi; and other senior officials concerned with economic and financial matters. The staff representatives were Mr. M. Edo (head-AFR), Mr. R. Sharer (AFR), Mr. H. Lorie (FAD), Mr. L. Dicks-Mireaux (AFR), Mr. A. De La Torre (ETR), and Miss D. Heflin (secretary-AFR).

Malawi is on the standard 12-month consultation cycle. The last Article IV consultation was concluded on January 5, 1987. Malawi continues to avail itself of the transitional arrangements of Article XIV.

In a letter to the Managing Director dated February 2, 1988 (Attachment I), the Malawian authorities request a stand-by arrangement in support of the Government's adjustment program covering the period January 1, 1988 to March 31, 1989. The last 12 months of the program period coincide with Malawi's 1988/89 fiscal year. The letter sets out the policies and measures to be applied during the program period, together with the proposed performance criteria for end-March and end-June 1988, and indicative targets for the remainder of the program period. In support of the program, they request a stand-by arrangement from the Fund in an amount equivalent to SDR 13.02 million, or 35 percent of quota. A waiver of the limitations in Article V, Section 3(b) (iii) would be required. The proposed arrangement envisages six purchases. As the Fund's holdings of Malawi kwacha under the regular tranches are well within the first credit tranche, 1/ the initial purchase under the proposed arrangement would be for SDR 9.25 million, equivalent to 24.9 percent of quota. The remaining amount, equivalent to 10.1 percent of quota, would be disbursed in five equal purchases of SDR 0.75 million each (Table 1). The second and third purchases are subject to observance of performance criteria for end-March and end-June 1988, and, for the third purchase, completion of the first program review with the Fund before end-June 1988. The remaining three purchases are subject to observance of performance criteria for end-September and end-December 1988 and end-March 1989, respectively, which will be established at the time of the first review. In addition, the fifth purchase is subject to

---

1/ The outstanding obligations relate mostly to past purchases of borrowed resources under the extended Fund facility and compensatory financing facility.

Table 1. Malawi: Purchases and Repurchases Under Proposed Stand-By Arrangement, December 1987-June 1989

	Outstanding at December 31, 1987	1988 Jan.-March	1988 April-June	1988 July-Sept.	1988 Oct.-Dec.	1989 Jan.-March	1989 April-June
			(In millions of SDRs)				
Net use of Fund credit 1/		3.77	-4.61	-2.77	-6.61	-3.44	-4.93
Transactions under tranche policies		7.02	-2.89	-1.04	-4.88	-1.71	-3.20
Purchases		9.25	0.75	0.75	0.75	0.75	0.75
Ordinary resources		9.25	0.75	0.75	0.75	0.75	0.75
Borrowed resources		—	—	—	—	—	—
Repurchases		-2.23	-3.64	-1.80	-5.64	-2.47	-3.96
Ordinary resources		-0.85	-0.30	-0.42	-0.72	-0.71	-0.71
Borrowed resources		-1.38	-3.34	-1.38	-4.92	-1.76	-3.25
Transactions under special facilities		-3.25	-1.73	-1.73	-1.73	-1.73	-1.73
Purchases		—	—	—	—	—	—
Repurchases		-3.25	-1.73	-1.73	-1.73	-1.73	-1.73
Total Fund credit outstanding	77.74	81.51	76.90	74.13	67.52	64.09	59.16
Under tranche policies	64.14	71.16	68.28	67.23	62.35	60.64	57.43
Under special facilities	13.60	10.35	8.63	6.90	5.18	3.45	1.73
			(In percent of quota)				
Total Fund credit outstanding	208.99	219.12	206.72	199.28	181.52	172.28	159.03
Under tranche policies	172.43	191.29	183.54	180.73	167.60	163.00	154.39
Under special facilities	36.56	27.82	23.19	18.55	13.91	9.27	4.64
Memorandum item:			(In millions of SDRs)				
Trust Fund							
Repayments	-0.66	-0.64	-0.56	-0.64	-0.20	-0.64	
Amount outstanding	4.69	4.03	3.39	2.83	2.19	1.99	1.35

Source: IMF Treasurer's Department.

1/ Excluding any possible disbursements under the SAF or ESAF.

completion of the second program review with the Fund before end-December 1988.

Malawi has met all financial obligations to the Fund on a timely basis. During 1986 and 1987, including charges, these amounted to SDR 61.3 million; during this period Malawi made no purchases from the Fund, and thus outstanding use of Fund credit was reduced from 328 percent of quota to 209 percent of quota.

The Fund staff has continued to collaborate closely with the World Bank staff in assisting Malawi to develop policies for the 15-month program period and for the medium term. In November 1987, a World Bank public expenditure review mission overlapped with the Fund mission to facilitate coordination in assisting the Malawian authorities to prepare a policy framework paper. The authorities have indicated their intention to submit, at the time of the first program review, a request for a three-year structural adjustment arrangement in the amount that will be available to Malawi under the enhanced structural adjustment facility (ESAF), and the first annual arrangement thereunder. Assuming all purchases under the proposed stand-by arrangement are made as scheduled, Malawi's outstanding use of Fund credit would be 159 percent of quota at the end of June 1989. Summary statements on Malawi's relations with the Fund and with the World Bank Group are provided in Appendix I and Appendix II, respectively; the proposed schedule of purchases during the period of the stand-by arrangement is shown in Appendix III; statistical issues are discussed in Appendix IV; and basic economic and financial data are presented in Appendix V.

II. Background to the Discussions

In the 15-year period following independence in 1964, Malawi's growth performance was highly favorable. Led by the agricultural sector, real GDP growth averaged about 5.5 percent per annum, and real per capita income rose by about 45 percent. Since the late 1970s, however, financial and economic imbalances have hindered performance; during the 1980s to date, real GDP growth has averaged below 2 percent per annum, and real per capita income has declined by about 10 percent. These difficulties related in part to external developments, particularly political instability throughout the region. However, they also reflected domestic policy-related factors. To address these problems, the Government implemented adjustment programs in the context of successive arrangements with the Fund, as well as three structural adjustment loans (SALs) with the World Bank. Considerable progress was made in realigning prices and incentives, a number of measures were adopted to address structural problems, and domestic and external financial imbalances were reduced, particularly in 1984 when exceptionally favorable external conditions prevailed.

However, since 1985 there has been a substantial weakening of economic performance and prospects, again partly reflecting adverse

external circumstances, particularly the complete closure since end-1984 of external transport routes through Mozambique, and declining terms of trade. However, it also reflected overly expansionary fiscal policies. The central government budget deficit (before grants) rose to 9.6 percent of GDP in 1985/86 (April-March) and reached 12.5 percent of GDP in 1986/87 (Table 2). The revenue/GDP ratio declined slightly while the expenditure ratio rose sharply, from 29.1 percent in 1984/85 to 32.8 percent in 1986/87, reflecting the cost of building up a strategic grain reserve, expenditures related to regional political instability, as well as expenditure overruns. Public sector imbalances were also exacerbated by financial difficulties of the parastatal sector, particularly for the Agricultural Development Marketing Corporation (ADMARC), on account of crop trading losses and expenses incurred in respect of the strategic grain reserve.

The external position also worsened. Export volumes declined from the exceptionally high levels of 1984, and there was a sharp deterioration in the terms of trade, by 19 percent during 1985-86. The current account deficit reached 8.2 percent of GDP in 1985 and 6.1 percent in 1986. At the same time, the short-term capital inflows of earlier years were reversed, and despite large SAL-related inflows, the overall balance of payments showed deficits of SDR 46 million and SDR 67 million in 1985 and 1986, respectively. During the two-year period debt service rose only slightly in SDR terms, but as exports declined this represented an increase in the debt service ratio, from 38 percent in 1984 to 57 percent in 1986. During 1985-86 all debt service obligations continued to be met in full. However, in 1986 the reduced availability of foreign exchange, combined with the high level of domestic demand, led to the introduction of quantitative restrictions on the approval of foreign exchange applications with respect to private sector import payments. Arrears emerged with respect to external trade payments, which by end-1986 had reached SDR 44 million. Inflation rose to 15 percent per annum during 1985-86, and real growth began to decline, amounting to 2.2 percent in 1986 or 1 percent below the population growth rate, mainly in response to the emerging foreign exchange difficulties.

III. Developments in 1987

Economic conditions remained difficult in 1987. External circumstances did not improve, and their domestic implications were exacerbated by an influx of displaced persons from Mozambique, estimated to have reached more than 300,000 persons by year-end. Also, toward the end of the year a food shortage emerged as a result of a shortfall in maize production. In the course of the year the Malawian authorities maintained close contact with the staffs of the Fund and of the World Bank and continued to implement reform measures. Fund missions visited Malawi in February and in May 1987, and subsequently the authorities adopted a "shadow program" in advance of reaching understandings on a more comprehensive program of measures. In addition to fiscal and

Table 2. Malawi: Selected Economic and Financial Indicators, 1982-89

	1982	1983	1984	1985	1986	1987 Est./Prog.	1988 Prog.	1989 Proj.
	(Annual percentage change; unless otherwise specified)							
National income								
GDP at constant factor cost	2.7	3.5	4.5	4.2	2.2	-0.4	1.5	3.3
GDP deflator	9.7	11.2	12.8	13.5	12.6	26.2	20.0	10.0
Consumer prices	9.7	12.4	12.4	14.9	14.8	26.2	20.0	10.0
External sector								
Exports, f.o.b. (millions of SDRs)	217.1	230.3	308.0	246.2	211.6	223.8	204.5	226.5
Imports, c.i.f. (millions of SDRs)	-276.4	288.9	263.3	282.5	218.9	230.3	267.1	253.8
Export volume	-7.4	2.4	27.8	-3.9	3.0	5.8	-7.6	7.3
Import volume	-5.0	4.4	-16.4	11.9	-13.0	0.3	5.0	4.5
Terms of trade (deterioration -)	-0.4	-0.7	-1.4	-13.2	-6.4	-2.4	-1.0	0.2
Nominal effective exchange rate, year-end (depreciation -)	-7.4	-2.1	4.4	-6.3	-21.4	-12.4	...	...
Real effective exchange rate, year-end (depreciation -)	-5.7	-2.6	9.8	-4.4	-15.2	1.4	...	...
Government budget 1/								
Revenue	10.6	17.0	23.5	25.1	11.5	10.3	23.4	...
Total expenditure	1.9	7.9	16.5	27.9	25.2	8.7	11.2	...
Money and credit 1/								
Net domestic assets (increase) 2/	22.5	--	30.9	27.8	10.4	6.0	2.1	...
Credit to Government (increase) 1/ 2/	9.6	2.5	4.1 3/	21.5	18.7	19.5	10.5	...
Money and quasi-money (M2) (increase) 2/	13.4	0.6	39.6	-3.5	20.6	45.0	15.7	...
Velocity (GDP relative to M2)	5.1	5.4	5.3	5.6	5.8	5.4	5.4	...
Interest rate (annual rate, 12-month time deposits)	10.75	12.75	12.75	14.25	14.25	17.25	...	...
	(In percent of GDP)							
Central Government								
Overall deficit 1/								
Excluding official transfers	12.1	9.7	8.7 4/	9.6	12.5	10.7	8.1	...
Including official transfers	8.8	7.5	6.3 4/	7.5	9.2	7.1	4.9	...
Domestic bank financing 1/	1.6	0.4	0.6	3.5	2.5	2.5	1.7	...
Foreign financing 1/	5.8	6.3	3.1	3.2	4.7	3.4	2.6	...
Gross fixed capital formation	14.6	13.7	13.0	12.8	11.0	11.4	11.5	...
Gross national saving 5/	8.2	6.2	15.0	8.2	8.6	9.4	9.2	...
External current account								
Excluding official transfers and emergency maize imports	-10.8	-10.9	-1.4	-8.2	-6.1	-3.6	-7.3	-6.1
Including official transfers	-7.7	-8.5	0.6	-6.1	-4.6	-2.0	-5.8	-4.3
Debt service ratio 6/	52.7	49.9	37.6	44.5	56.9	45.8	49.9	43.5
Interest payments 6/	16.2	16.4	13.0	16.2	19.3	16.7	16.4	14.3
	(In millions of SDRs, unless otherwise specified)							
Overall balance of payments 7/	-48.3	-82.3	42.2	-45.7	-67.0	51.9	1.3	18.2
Gross official reserves (weeks of imports, c.i.f.)	3.9	2.3	11.5	7.3	3.7	8.0	9.0	11.0
External debt (disbursed and outstanding, end of period)	711.8	778.4	870.0	853.9	845.1	865.1	892.6	949.4
External payments arrears (end of period)	--	--	--	--	43.8	33.2	--	--

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

1/ Fiscal year beginning April 1 of the year indicated. Excludes transfers to the Reserve Bank of Malawi in the form of noninterest-bearing promissory notes to cover central bank revaluation losses on net foreign liabilities.

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

3/ Excludes special issue of Local Registered Stock for the Government's assumption of Press debt; including this, the change is 26.6 percent of broad money. Also, adjusted for the redefinition of net credit to Government which removed MK 11.0 million from government deposits.

4/ Excluding the special issue of Local Registered Stock of MK 54.2 million for the Government's assumption of Press debt.

5/ Excluding the financing of stock building.

6/ Including IMF charges and repurchases, and estimated debt service on private debt. Before debt relief.

7/ Before debt relief but after SAL and related inflows.

monetary measures, actions included a number of institutional reforms, particularly to improve financial monitoring and control. To provide a broad platform of suppr t for the formulation, adoption, and implementation of adjustment policies at the highest levels of Government, a new policy organ, the National Economic Council (NEC) was created. The NEC comprises senior members of the Malawi Congress Party, cabinet ministers, and key representatives of the business community.

1. Government finances

During 1987 the authorities took a number of institutional and policy actions to improve fiscal performance. The 1987/88 budget as introduced aimed at an overall deficit of MK 233 million (before grants), or 8.7 percent of then estimated GDP with revenues of 19.5 percent of GDP, and expenditure of 28.2 percent of GDP. Including the targeted nonrecurrence of extrabudgetary expenditures, this would result in a decline of overall expenditure of almost 5 percentage points of GDP from the previous year. Revenue actions were taken, estimated to yield MK 32.5 million, including higher surtax rates on imports and domestic production, imposition of additional duty on certain luxury goods, introduction of profit taxation for commercial statutory bodies, a tax on certain outward remittances abroad, and some additional taxes on local headquarters of foreign-owned companies. However, it soon became evident that actual developments were more expansionary than had been anticipated. Revenue actions had not been fully implemented as announced (particularly concerning the surtax), and expenditures were exceeding the budget estimates, reflecting the larger-than-expected impact of the wage and salary increase given in 1986/87, higher interest costs, underestimation of some special outlays in connection with the regional political situation, and other recurrent cost overruns.

Subsequently, the authorities introduced further fiscal actions in August 1987 in the context of a "shadow program." Additional revenue measures included a doubling of the import levy rate from 5 percent to 10 percent, a surcharge on imported used cars, and additional taxes on a number of public services. In addition, domestic prices of petroleum products were raised by 15 percent to ensure that budget revenues from petroleum would be broadly maintained. On the expenditure side, to contain the wage bill some nonestablished positions were eliminated and a limited retrenchment program initiated; other current expenditure savings were to be effected in connection with domestically funded construction projects. These measures were supplemented by tightening implementation of the expenditure control mechanisms already initiated. Ministries and departments were required to place their funds in accounts at the Reserve Bank, which began to monitor strictly these balances on a weekly basis. The actions of the Government's expenditure monitoring committee were intensified through more frequent reviews of outlays, together with subsequent adjustment to monthly allocations. Also, a new committee to vet government outlays on imports was introduced.

While these actions aimed at constraining the deficit in relation to GDP to around the level anticipated in the budget, a number of developments forced the acceptance of a less ambitious target. Revised expenditure data which subsequently became available indicated that overruns earlier in the fiscal year, including for wages and salaries and other recurrent expenditures, were larger than anticipated. Revenues were also lower than envisaged, mainly on account of the negative impact of the tightening of the foreign exchange position and poor growth performance on tax yields.

Reflecting the above developments, the deficit for 1987/88 is now targeted to be MK 323 million, or 10.7 percent of revised GDP, a reduction of 1.8 percentage points of GDP from the previous year's outcome (Table 3). Revenues are now projected to amount to MK 544 million, or 17.9 percent of revised GDP, compared with MK 563 million, or 20.9 percent of GDP aimed at in the shadow program and 20.3 percent of GDP for 1986/87. Expenditure is projected to reach MK 862 million, or 28.4 percent of revised GDP, compared with MK 789 million, or 29.3 percent of GDP anticipated in the shadow program and 32.8 percent of GDP for 1986/87. Expenditure for 1987/88 includes outlays for emergency maize imports (equivalent to almost 0.4 percent of GDP), as detailed below. It also includes an amount of MK 5.5 million to cover the subsidy to the Fertilizer Revolving Fund for its operations in 1986/87.

The above overall deficit and expenditure targets assume a sharp reversal of the expenditure overruns that occurred before the improved control mechanisms were effectively in place. Expenditure data for the three-month period immediately following effective introduction of the controls indicate that recurrent outlays (excluding emergency maize outlays), have now been reduced to levels in line with those anticipated under the shadow program.

Net foreign financing is estimated at MK 104 million, in line with original projections after adjusting for exchange rate changes, or about 30 percent below the 1986/87 outturn in SDR terms, reflecting lower SAL-related inflows. Domestic financing is projected to rise slightly from MK 110 million to MK 113 million, with domestic bank financing increasing from MK 61 million (2.5 percent of GDP and 18.7 percent of the beginning period broad money stock) to MK 77 million (2.5 percent of GDP and 19.6 percent of the beginning period).

2. External developments

External developments showed an improvement in 1987, but conditions remained difficult. In February the Malawi kwacha was devalued by 20 percent against its currency basket. However, price developments in Malawi relative to its trading partners were such that by year end the real effect of the depreciation had been largely eroded (Chart 1). The current account deficit (excluding official transfers and emergency maize imports) is estimated to have been reduced by 2.5 percentage

Table 3. Malawi: Central Government Operations, 1985/86-1988/89

(In millions of Malawi kwacha)

	1985/86 Outturn	1986/87 Outturn	1987/88 Shadow Program 1/	1987/88 Program	1988/89 Program
Revenue (excluding grants)	442.0	492.9	562.6	543.9	671.0
Tax	373.4	391.0	459.4	445.6	525.0
Nontax	68.6	101.9	103.2	98.3	111.0
Revenue measures	...	...	...	...	35.0
Expenditure	643.5	797.0	788.8	861.6	964.0
Current expenditure	457.3	560.5	583.0	639.2	700.5
Wages and salaries	104.6	132.0	144.3	155.6	163.4
Interest	124.9 2/	152.2	148.0	159.6 3/	184.7 3/
Other current expenditure	227.8	276.3	290.7	324.0	352.4
Other goods and services	155.1	207.9	226.1	259.4	...
Of which: special expenditure	(...)	(32.5)	(27.0)	(28.0)	(...)
Grants and subsidies	43.6	53.2	57.1	57.1	...
Other	29.1	15.2	7.5	7.5	...
Development expenditure	160.2	189.8	205.8	215.0	251.3
Domestically financed	29.3	33.8	33.6	35.8	...
Foreign financed	130.9	156.0	172.3	179.2	...
Extrabudgetary expenditure 4/	26.0	46.7	--	7.4	12.2
Strategic grain reserve	26.0	46.7	--	--	--
Net cost emergency maize imports	--	--	--	7.4	12.2
Errors, omissions, adjust. 5/	--	--	--	5.1	--
Overall deficit (excluding grants) 4/	-201.5	-304.1	-226.2	-322.8	-293.0
Grants	44.8	79.3	102.3	106.2	117.0
SAL-related	--	21.8	41.7	45.3	26.7
Others	44.8	57.5	60.6	60.9	90.3
Overall deficit (including grants)	-156.7	-224.8	-123.9	-216.6	-176.0
Financing (excluding grants)	156.7	224.8	123.9	216.6	176.0
Foreign (net)	51.8	115.0	91.4	103.6	95.8
Borrowing	137.7	218.3	193.9	214.2	234.4
Project loans	...	93.0	111.5	127.0	132.0
SAL-related	...	125.3	82.4	87.2	102.4
Repayments 3/	85.9	103.3	102.4	110.6	138.6
Domestic (net)	104.9	109.8	32.5	113.0	80.2
Banking system 4/	72.4	60.9	17.5	76.8	60.0
Other	32.5	48.9	15.0	36.2	20.2
Memorandum items:					
GDP (fiscal year)	2,087	2,432	2,689	3,030	3,619
		(In percent of GDP)			
Revenue (excluding grants)	21.2	20.3	20.9	17.9	18.5
Expenditure 4/	30.8	32.8	29.3	28.4	26.6
Overall deficit (excluding grants) 4/	-9.6	-12.5	-8.4	-10.7 6/	-8.1

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

1/ As agreed with the Fund mission in May 1987.
2/ Estimate.
3/ On due basis; the domestic counterpart of debt relief will be blocked by the Reserve Bank.
4/ Excluding transfers to the Reserve Bank of Malawi, in the form of noninterest-bearing promissory notes, to cover central bank valuation losses on its stock of net foreign liabilities.
5/ The amount of MK 5.1 million shown for 1987/88 mainly reflects movements in net domestic financing during the first two quarters of the year, which cannot yet be explained by above the line developments as regards revenue or expenditure.

points of GDP to 3.6 percent of GDP, as imports of goods and nonfactor services continued to be held well below historical levels while merchandise exports, led by tobacco, rebounded in volume terms and inflows of private transfers rose significantly (Table 4). The capital account is estimated to have shown a sharp turnaround from a net outflow of SDR 3 million in 1986 to an estimated inflow of SDR 93 million in 1987, mainly reflecting a reversal of the short-term and unidentified outflows that had occurred in 1986. Although SAL disbursements (including cofinancing) fell sharply, government amortization payments were also reduced leaving net government loans at SDR 38 million, slightly below the level of 1986. These developments are estimated to have led to an overall balance of payments surplus of about SDR 52 million in 1987, as against a deficit of SDR 67 million in 1986.

The increases in foreign exchange receipts from exports and capital inflows took place mainly during the last quarter of 1987 and, as a result, Malawi's external financial position remained extremely tight throughout most of the year, and the restrictions on the approval of private sector imports were maintained. However, a number of institutional actions were introduced to streamline the foreign exchange allocation system. In addition to improved controls on Government's use of foreign exchange, emphasis was placed on productive inputs rather than consumer goods, and approval procedures were modified to enable companies to determine their own needs and priorities within an overall monthly allocation. Nevertheless, the system demonstrated a number of inefficiencies commonly associated with administered allocation of scarce resources.

To improve international confidence in Malawi, the authorities used the improved fourth quarter foreign exchange position to regularize short-term trade financing arrangements as quickly as possible. To this end, in 1987 the Reserve Bank repaid short-term trade-related commitments to commercial bank creditors of SDR 18.4 million. In addition, external arrears on short-term trade payments were reduced from SDR 43.8 million at end-1986 to only SDR 17.6 million by end-1987.

In 1987 total scheduled debt service was reduced somewhat, owing mainly to lower amortization payments on medium-term loans to financial institutions. Nevertheless, the debt service ratio remained high at 46 percent, and, in view of the impact of the continued import compression on economic activity and the large proportion of debt due to multilateral institutions and thus not reschedulable, in August 1987 the authorities approached the Paris and London Clubs for a comprehensive debt rescheduling. At the same time, all service payments to Paris Club creditors and all principal payments to London Club creditors were suspended pending consideration of the request. This suspension reduced actual debt service payments in 1987 by about SDR 14 million, or 6 percent of exports of goods and nonfactor services, which became arrears pending consideration of the rescheduling request. However, the staff estimates that not all this amount will be eligible for rescheduling.

Table 4. Malawi: Balance of Payments, 1982-87

(In millions of SDRs)

	1982	1983	1984	1985	1986	Est. 1987
Current account	-115.4	-124.9	-16.2	-95.3	-63.8	-41.4
Trade balance	-59.8	-58.7	44.7	-36.3	-7.3	-6.5
Exports, f.o.b.	217.1	230.3	308.0	246.2	211.6	223.8
Imports, c.i.f.	-276.9	-289.9	-263.3	-282.5	-218.9	-230.3
Non-maize imports, f.o.b	-179.9	-188.0	-158.0	-169.4	-131.4	-134.8
C.i.f. margin	-97.1	-100.9	-105.3	-113.1	-87.6	-89.9
Maize imports, c.i.f.						-5.6
Services and private transfers	-55.6	-66.2	-60.9	-59.0	-56.6	-34.9
Nonfactor services	-10.2	-14.0	-21.7	-17.2	-18.4	-13.5
Receipts	21.2	22.0	26.4	26.0	19.0	15.4
Payments	-31.4	-35.9	-48.1	-43.2	-37.4	-28.9
Factor services	-63.6	-60.0	-54.4	-52.1	-50.4	-45.4
Receipts	1.4	1.3	3.6	5.4	2.8	2.1
Payments	-65.0	-61.2	-58.0	-57.5	-53.2	-47.5
Interest	-38.5	-41.4	-43.3	-44.1	-44.4	-40.0
Other	-10.9	-19.8	-14.6	-13.4	-8.8	-7.5
Private transfers	18.2	7.7	15.3	10.3	12.2	24.0
Receipts	28.7	22.5	26.5	21.2	21.6	30.9
Payments	-10.6	-14.7	-11.3	-10.9	-9.3	-6.9
Capital account	67.1	42.5	58.4	49.6	-3.2	93.3
Long-term, net	37.8	34.6	59.7	42.0	60.1	72.3
Government transfers	32.9	27.6	23.8	24.1	24.9	28.7
Credit	33.8	28.6	25.7	26.0	26.5	29.9
Of which:						
SAL-related grants	(--)	(--)	(--)	(--)	(9.3)	(7.0)
Grants for maize	(--)	(--)	(--)	(--)	(--)	(4.4)
Debit	-0.9	-1.0	-1.9	-1.8	-1.6	-1.2
Government loans	20.3	22.0	51.1	27.4	40.5	38.1
Credit	61.5	60.8	90.5	62.0	89.6	72.5
Of which:						
SAL-related loans	(18.1)	(--)	(52.0)	(7.7)	(63.9)	(38.5)
Debit	-41.2	-38.8	-39.4	-34.6	-49.1	-34.4
Public enterprises	-18.4	-28.4	-12.9	-15.2	-9.3	2.4
Credit	6.9	0.7	0.7	7.0	0.2	9.0
Debit	-25.2	-29.1	-13.6	-22.2	-9.5	-6.6
Private sector	3.0	13.5	-2.3	5.6	3.9	3.1
Credit	11.0	19.5	6.7	9.9	11.6	8.0
Debit	-8.0	-6.1	-9.0	-4.2	-7.6	-4.9
Short-term and unidentified	29.3	7.9	-1.3	7.6	-63.2	21.1
Overall balance	-48.3	-82.3	42.2	-45.7	-67.0	51.9
Financing	48.3	82.3	-42.2	45.7	67.0	-51.9
Official net foreign assets (increase -)	31.4	27.0	-65.2	39.0	20.8	-41.8
Gross official reserves (increase -)	25.4	7.7	-45.2	18.2	24.1	-19.0
IMF purchases	14.7	34.2	37.8	23.0	--	--
IMF repurchases	-12.6	-10.3	-20.4	-16.0	-20.6	-23.6
Change in other liabilities, net	3.9	-4.6	-37.4	13.8	17.3	0.8
Change in arrears	--	--	--	--	43.8	-10.6
Import-related	--	--	--	--	43.8	-26.2
Debt service-related	--	--	--	--	--	15.7 1/
Debt relief	16.9	55.3	23.0	6.7	2.4	0.4
Memorandum items:						
Current account (percent of GDP)						
Excluding official transfers and emergency maize imports	-10.6	-10.9	-1.4	-8.2	-6.1	-3.6
Including official transfers	-7.7	-8.5	0.6	-6.1	-4.6	-2.0
Overall balance (percent of GDP)	-4.5	-7.2	3.6	-3.9	-6.4	5.2
Gross official reserves						
End-period stock	20.5	12.8	58.0	39.8	15.7	34.7
In weeks of c.i.f. non-maize imports	3.9	2.3	11.5	7.3	3.7	8.0
C.i.f. margin (in percent of c.i.f. imports)	35.0	35.0	40.0	40.0	40.0	40.0

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

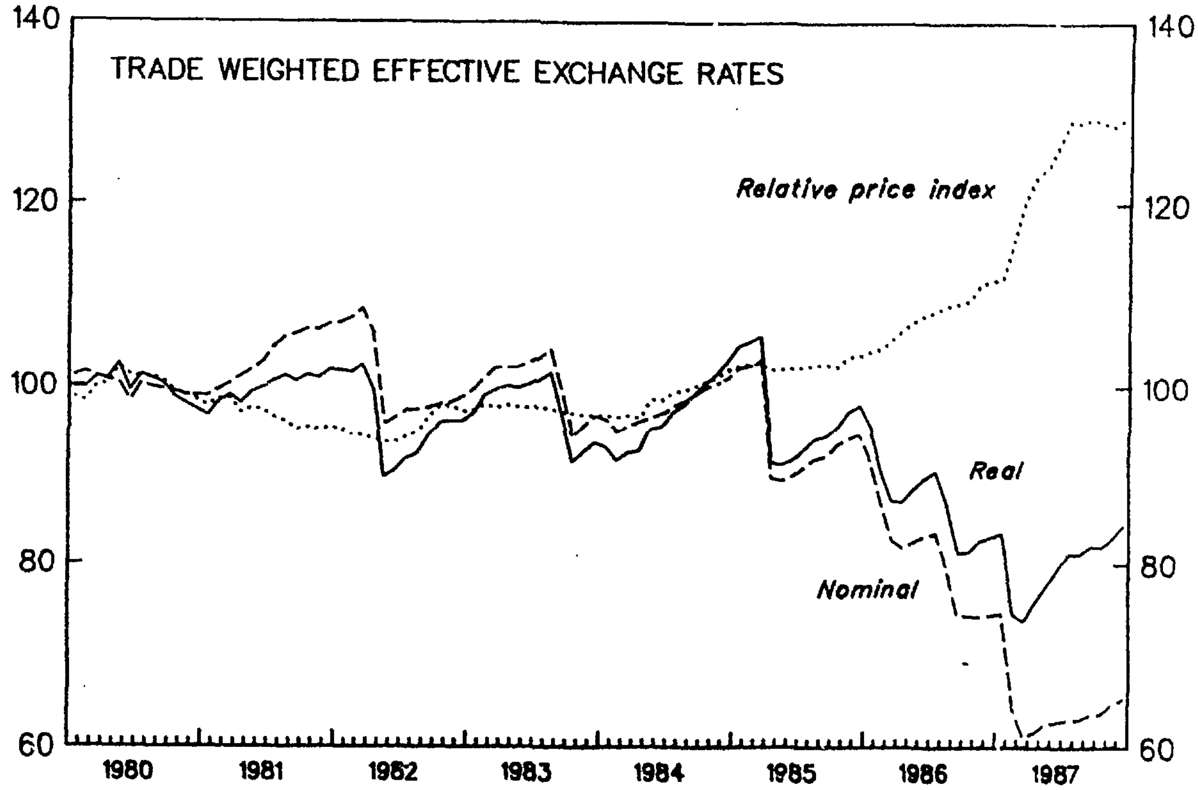
1/ Estimated debt service payments to Paris Club creditors and principal payments to London Club creditors suspended since end-August 1987 pending Malawi's request for debt rescheduling.

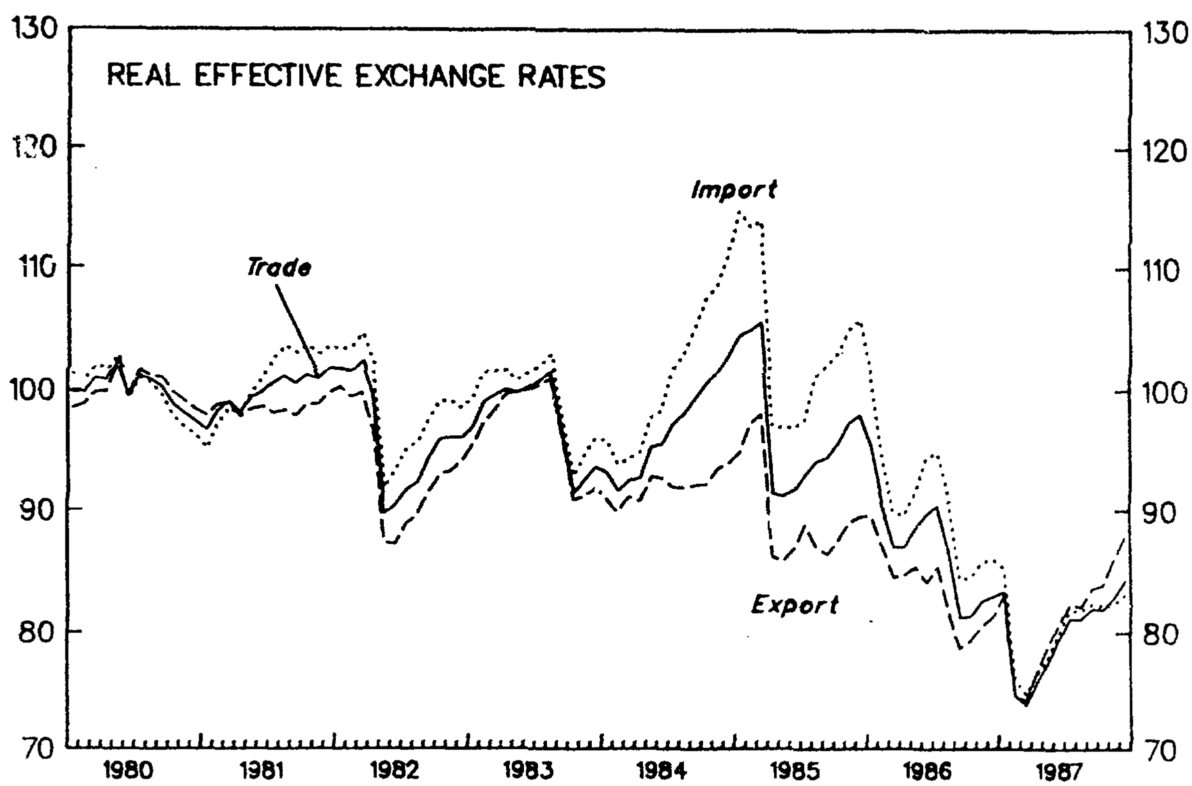
CHART 1

MALAWI

INDICES OF EFFECTIVE EXCHANGE RATES, JAN. 1980 TO DEC. 1987

(Period average, 1980=100)





Source: IFS and; IMF staff calculations.

3. Money and credit

In 1987 net domestic assets fell by MK 66 million (Table 5) equivalent to 15.1 percent of the beginning period broad money stock. Domestic credit declined by MK 37 million or 4.9 percent, equivalent to 8.5 percent of the beginning period broad money stock. Reflecting the fiscal developments noted above, net credit to Government rose MK 33 million or 7.3 percent during the calendar year, but this is partly offset by new blocked deposits at the Reserve Bank into which the Government pays the domestic counterpart of suspended external debt service payments. Net credit to statutory bodies fell from MK 60 million to MK 21 million or 65 percent reflecting a high level of seasonal deposits at year-end. At the same time, credit to the private sector is estimated to have declined by 13.2 percent. This reflects increased company liquidity owing to the continuing constraints on imports and other foreign exchange payments and its effect on reducing domestic activity and investment opportunities, as well as favorable conditions in the tobacco sector.

In July 1987, in connection with the shadow program, interest rates on deposits were raised by 3 percentage points, bringing the 12-month deposit rate to 17 percent, and maximum lending rates were deregulated. In response, commercial banks raised base lending rates by 4 percentage points to 20 percent, with an increase of 3 percentage points for the agricultural sector. The interest rate increase was intended to raise domestic savings and reinforce restraint on private sector credit, which had risen by 15 percent during December-June, although this largely reflected seasonal agricultural demands. However, the impact of the foreign exchange constraint on loan demand was severe in the second half of the year, and in consequence, commercial bank liquidity ratios rose to about double the 30 percent obligatory reserve ratio. In response, the commercial banks began to refuse to accept longer-term deposits on account of the losses entailed by the higher interest rates. Reflecting the increase in company liquidity as a result of the constraints on imports and other external payments, the money supply rose by 28 percent, compared with 24 percent in 1986.

4. The real economy

a. Overall performance

According to provisional estimates real GDP declined by 0.4 percent in 1987. This mainly reflected poor performances by the agricultural and manufacturing sectors, which together account for about one half of GDP, and whose performance in turn affects all other sectors. The main adverse factors limiting output were the foreign exchange constraint, adverse weather conditions early in the year, and continued severe transportation difficulties. Manufacturing output remained at about the level of 1984, and even this entailed a heavy rundown of stocks, which by year-end were depleted. The share of consumption in GDP remained un-

Table 5. Malawi: Monetary Survey, December 1985-March 1989

(In millions of Malawi kwacha)

	1985	1986		1987				1988				1989
	Dec.	March	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.	March
								Program				Prog.
Foreign assets (net)	-223.4	-304.7	333.1	-341.1	-410.4	-254.8	-247.5	-290.6	-292.5	-231.0	-201.0	-213.3
Gross foreign assets	86.4	61.8	47.9	65.9	63.5	149.9	...	110.6	139.1	187.4	190.2	181.1
Foreign liabilities	-309.8	-366.5	-381.0	-407.0	-473.9	-404.7	...	-401.2	431.6	-418.4	-391.2	-394.5
Domestic assets (net) 1/	515.2	575.0	656.1	608.8	734.8	675.9	590.3	632.5	692.7	715.2	648.8	644.7
Domestic credit	618.4	673.6	753.4	692.2	798.7	769.5	716.6	789.7	864.4	919.5	873.3	894.6
Credit to Government (net)	328.6	371.2	457.5	432.1	470.8	456.9	490.9	508.9	528.3	562.6	551.6	568.9
Credit to statutory bodies (net)	77.2	71.1	59.6	19.1	55.2	70.8	20.6	40.8	61.1	84.9	69.1	43.7
Credit to private sector	212.6	231.3	236.3	241.0	272.7	241.8	205.1	240.0	275.0	272.0	252.6	282.0
Other assets (net) 1/	-103.2	-98.6	-97.3	-83.4	-63.9	-93.6	-126.3	-157.2	-171.7	-204.3	-224.5	-249.9
Of which: new blocked deposits at Reserve Bank 2/	(--)	(--)	(--)	(--)	(--)	(-24.6)	(-48.7)	(-83.8)	(-104.3)	(-143.9)	(-165.1)	(-192.5)
Other items (net) 1/	-59.6	-55.4	-112.2	-125.2	-203.7	-214.6	-214.8	-228.0	-228.0	-228.0	-228.0	-228.0
Reserve Bank revaluation accounts 3/	-75.0	-75.0	-135.0	-148.0	-226.5	-237.4	-237.6	-250.8	-250.8	-250.8	-250.8	-250.8
SDR allocation	15.4	19.6	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8
Money plus quasi-money	351.4	325.7	435.2	392.9	528.1	635.7	557.6	569.9	628.2	712.2	675.8	659.4
Money	153.5	136.2	187.0	168.7	253.0	312.4	234.7	...	...	...	...	...
Quasi-money	197.9	189.5	248.2	224.2	275.1	323.3	322.9	...	...	...	...	...

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

1/ The definition of this aggregate has been changed from previous Board papers on Malawi. Blocked deposits at the Reserve Bank and capital accounts which had previously been classified under other liabilities (outside of net domestic assets) have been classified under other assets (net). The Reserve Bank's revaluation accounts, which had previously been included in capital accounts, are now seperately identified, and, together with Malawi's SDR allocation, are classified under other items (net).

2/ The kwacha counterpart of government and statutory bodies' debt service payments for which a rescheduling is being sought, are being paid as they fall due in blocked accounts at the Reserve Bank.

3/ Comprises the sum of the Reserve Bank's profit and loss on devaluation account and the value of promissory notes issued by the Government in respect of the Reserve Bank's devaluation losses on its outstanding stock of net foreign assets.

changed at about 85 percent, and gross fixed capital formation remained relatively depressed compared with historic levels.

Price developments also showed a marked deterioration. Inflation, as measured by the GDP deflator, is estimated to have reached 26 percent, compared with an average of about 12 percent during the three preceding years. The sharp increase in prices reflected mainly expansionary domestic financial policies as well as the effects of the February devaluation. In addition, the foreign exchange restrictions began to lead to prices reflecting a scarcity premium, and in the latter half of the year food prices began to reflect the shortage of domestic supply.

b. Domestic food security

An additional problem that became apparent in 1987 was a shortfall in domestic food production, the impact of which was exacerbated by the influx of displaced persons from Mozambique. Maize production was constrained by a combination of factors, particularly a deterioration in the producer price relative to competing cash crops, the most important being groundnuts, for which marketed output has risen sharply. This producer price policy was felt to be appropriate by the Malawian authorities and international agencies in view of several years of surplus maize production, a high level of stocks, and an objective of export diversification. In 1987 total food output was also affected by adverse rains, rising input costs, and pest infestation of cassava. In combination these factors are expected to result in a shortfall in the range of 120,000-180,000 tons. 1/ The Government has requested emergency food aid from the international community, and indications are that substantial food assistance is likely to be received. In addition, the Government has contracted for 35,000 tons of maize from neighboring countries, and is seeking supplies elsewhere. To allow for any additional net outlays, the Government has included a provision of MK 7 million in the 1987/88 budget, and MK 12 million for the 1988/89 budget. These amounts are based on a detailed set of assumptions in respect of aid commitments, commercial purchases, sources of supply, and the purchase, transportation, and distribution costs involved, as well as the timing of the transactions. Nevertheless, considerable uncertainty remains in this area, particularly with regard to the timing of the physical and financial flows involved.

c. Transportation

The major structural problem facing Malawi remains the external transportation bottlenecks, which have raised the c.i.f. margin on imports from 22 percent in the late 1970s to 35 percent by 1982 and an estimated 40 percent since 1985. Historically some 90 percent of

---

1/ Food demand for the displaced persons is expected to be fully met from international commitments of food aid already committed.

Malawi's trade was carried by rail through Mozambique, but regional political disturbances have resulted in most traffic being switched to a combination of road and rail routes to the South, with substantially higher unit costs. During 1987 some investments were made in rehabilitating the Nacala rail line, the lowest-cost feasible routing, in cooperation with Mozambique and international and bilateral donors, and toward year-end the line was reopened on a low-traffic experimental basis. The rail link to Beira, which historically accounted for some 60 percent of Malawi's total trade, is not expected to reopen in the foreseeable future. Other investments were made in the development of an alternative Northern Corridor route through Tanzania.

d. Statutory bodies

During 1987 a number of actions were taken to improve the performance of the parastatal sector. In particular, with respect to ADMARC, further structural and cost-cutting reforms contributed to a marked improvement in results. The reforms include rationalization of marketing infrastructure and staffing levels, management reforms, and asset restructuring and disposals. In this context, actions were taken to encourage private sector participation in the purchase and marketing of smallholder agricultural produce. Other recurrent cost and overhead expenses were reduced in the areas of vehicles, regional offices and depots, and administration. Some equity holdings and estates were divested, and a program for further divestment is being developed. Some loans from the Government and the Reserve Bank were rescheduled, and a repayment period was agreed to become effective April 1, 1988. On balance ADMARC's net overall surplus on all operations improved from MK 0.7 million in 1986/87 (April-March) to a projected MK 12 million for 1987/88 (Table 6). Within these totals the position on crop trading accounts improved from a loss of MK 16.6 million in 1986/87 to a profit of MK 2.5 million for 1987/88. The remaining losses are on account of the maize, groundnut, and cotton accounts, albeit at significantly lower levels than the previous year; it is anticipated that the position on these accounts will be improved in 1988/89.

There is also estimated to be a marked improvement in 1987/88 in the combined financial position of the nine other major parastatals, with almost all improving their profit performance. A wide range of tariff and price increases was implemented during the year and most enterprises are also in the course of implementing restructuring and cost control programs. On balance these nine parastatals are estimated to show a consolidated operating profit of MK 7.8 million for 1987/88, compared with a loss of MK 0.7 million for the preceding year.

IV. Report on the Discussions and the Program for 1988-89

At the time of the last Article IV consultation in Janua 1987, Executive Directors expressed concern at the deterioration in alawi's external and domestic finances. While recognizing that these

Table 6. Malawi: Selected Indicators of the Financial Performance of the Major Statutory Bodies, 1985/86-1988/89 1/

(*In millions of Malawi kwacha*)

	1985 or 1985/86	1986 or 1986/87	1987 or 1987/88 Proj.	1988 or 1988/89 Prov.
Combined accounts 2/				
Revenues	204.3	240.5	257.5	289.1
Interest charges	17.1	27.1	28.7	27.0
Profit or loss 3/	-21.0	-11.3	3.2	18.6
Of which: ADMARC	(-19.7) 4/	(-10.6)	(-4.6)	(-2.3)
Cashflow	...	12.8	0.2	5.0
Gross investment	27.8	51.3	57.9	87.9
ADMARC				
Net operating profit or loss on crop trading accounts	-17.8	-16.6	2.5	4.4
Of which: maize	(-5.6)	(-10.6)	(-4.4)	(-2.8)
tobacco	(-7.0)	(3.9)	(12.7)	(9.3)
groundnuts	(-4.8)	(-3.5)	(-2.1)	(-3.3)
cotton	(-0.7)	(-7.8)	(-5.3)	(-0.4)
Other revenues/expenses (net)	-1.9	6.0	-7.1	-6.7
Of which: net interest	(-1.6)	(-9.1)	(-10.2)	(-7.1)
Net profit or loss 3/	3.3 5/	-10.6	-4.6	-2.3
Other operations (net) 6/	-19.7	11.3	16.6	13.8
Overall surplus/deficit	-16.4	0.7	12.0	11.5
Financing	16.4	-0.7	-12.0	-11.5
Reserve Bank	8.7	0.8	-0.7	-4.1
Commercial Bank overdraft	10.3	-13.5	-5.9	-2.9
Use of cash balances	-2.5	0.8	-1.9	--
Government	12.1	8.7	--	-3.4
Export financing	-8.6	1.7	-1.7	--
Other borrowing	-3.6	0.8	-1.8	-1.1

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

1/ Includes ADMARC, Malawi Railways, Lilongwe Water Board, Electricity Supply Commission, Malawi Development Corporation, Malawi Housing Corporation, Air Malawi, Blantyre Water Board, Malawi Book Service, and Wood Industries. The first four statutory bodies have fiscal years April 1-March 31, the latter six January 1-December 31.
2/ Including ADMARC.
3/ After interest payments and depreciation.
4/ Excludes payment of MK 23 million by the Government for previous years costs related to the strategic grain reserve.
5/ Includes Government payment described in footnote 4.
6/ Includes net lending, investment, asset sales, stock movements and

developments were associated with adverse external developments, they stressed the impact of insufficiently tight demand management policies and the deterioration of the public sector financial performance. Particular concern was expressed that difficulties in monitoring and controlling expenditure continued to be a significant source of slippage. Directors emphasized the need for the authorities to respond quickly to deteriorating circumstances and to adopt a comprehensive adjustment effort aimed at achieving medium-term balance of payments viability, particularly as large-scale exceptional foreign financial inflows should be viewed as temporary in nature. Directors also emphasized that while improved finances for the public sector, including statutory bodies, was the most pressing need, flexibility in exchange rate and interest rate policies would also need to be an important part of the adjustment effort.

These issues were considered further during the recent discussions on the Article IV consultation, and on a program that could be supported by use of Fund resources. The authorities recognized the extent of the problems facing the economy, and that prudent financial policies, combined with structural reforms, need to be rapidly implemented if the rate of growth is to be returned to an annual increase exceeding the growth in population. They also recognized the need to restore the favorable international confidence in Malawi that prevailed in earlier years through addressing the issues of the heavy debt service burden, external arrears, and controls on private sector import payments.

1. Overall economic strategy and basic objectives

Conscious of the magnitude of the problems facing Malawi, the Malawian representatives emphasized that the Government had already initiated a series of measures aimed at economic adjustment. They recognized that the deteriorating external environment necessitated prudent fiscal and monetary policies aimed at balancing the supply and demand for foreign and domestic resources. They also recognized that the actions already initiated needed to be rapidly reinforced by a comprehensive set of policies and measures aimed at restoring growth and inflation rates to historical levels through Malawi's traditional reliance on liberal market-oriented policies.

Accordingly, as indicated in the letter of intent, the authorities have adopted a program for the 15-month period beginning January 1, 1988, the basic objectives of which are (a) to attain a rate of real growth of 1.5 percent for 1988 after the decline in 1987, and thereafter to achieve annual real growth rates of 3.0-3.5 percent, rising to 4.0-5.0 percent by 1992; (b) to reduce the annual rate of inflation to at most 20 percent in 1988, and thereafter to achieve a steady reduction to about 5 percent per annum by 1991-92; and (c) to move steadily toward a sustainable external financial position, consistent with the growth targets, while removing existing restrictions on current payments and eliminating external payments arrears.

As also noted in their letter, the authorities are aware of the need to address the present economic difficulties in the context of a medium-term adjustment effort. They therefore intend to undertake further structural and financial reforms in the period ahead in close collaboration with the staffs of the Fund and the World Bank. The authorities will be formulating these plans in the context of a three-year program covering the period 1988/89-1990/91, in support of which they intend to request from the Fund a three-year structural adjustment arrangement in the amount that would be available to Malawi under the enhanced structural adjustment facility, and the first annual arrangement thereunder.

2. Fiscal policies

For the initial three months of the program period, January-March 1988, fiscal policy will focus on ensuring that the programmed outturn for the 1987/88 fiscal year is achieved. This will entail in particular a close monitoring of expenditures so that the projected increase of MK 18 million in net credit to Government from the banking system for this period is not exceeded. Subsequently, fiscal policy will aim at a further significant reduction in the budget deficit to curtail aggregate demand pressures, thus facilitating increased private sector activity. Accordingly, the 1988/89 program will aim at reducing the deficit (before grants) by a further 2.6 percentage points of GDP, to 8.1 percent of GDP. After grants, the reduction would be from 7.1 percent to 4.9 percent of GDP. Revenues are projected to rise from 17.9 percent of GDP to 18.5 percent of GDP, while total expenditure will be reduced from 28.4 percent of GDP to 26.6 percent of GDP. On the financing side, net foreign financing will decline slightly in nominal terms to MK 96 million, reflecting higher amortization payments falling due. 1/ Domestic financing will be sharply reduced, from MK 113 million to MK 80 million, with net credit to Government from the banking system falling from MK 77 million to MK 60 million. In the course of the discussions, the staff reached understandings with the authorities on a provisional list of policies and measures to be included in the budget in order to achieve the program's fiscal targets. Reaching understandings on the 1988/89 budget, as introduced, would be a major element of the first program review. Furthermore, to facilitate close monitoring of budgetary developments, quarterly indicative targets for government expenditures and for the overall deficit will be established at the time of the review.

On the revenue side, in the absence of any measures, it is estimated that the revenue/GDP ratio would have declined (for the third year in a row) to about 17.6 percent of GDP, mainly on account of the inelasticity of the tax system in a worsening inflationary environment, and of continued weakness in the effective yield from import-related taxes. On

1/ The domestic counterpart of external debt service payments subject to rescheduling will continue to be blocked by the Reserve Bank.

this basis, revenue measures equivalent to about 1 percent of GDP, equivalent to about MK 35 million, will be required, giving an overall increase in revenues of 23 percent to MK 671 million. The provisional list of measures includes: an increase of 2-3 percentage points in surtax rates, to yield about MK 14 million; an increase in a number of trade, business, and transportation licenses and fees, to yield about MK 10 million; an increase in the company tax rate from 50 percent to 55 percent, to yield about MK 5 million; an increase in specific excise duties on beverages and manufactured tobacco by about 40 percent, to yield about MK 4 million; an increase in the income tax rate applying to the highest earned income bracket, to yield about MK 1 million; and an extension of the accommodation tax, tc yield about MK 1 million. The list of revenue measures will be finalized at the time of the first review; however, during the discussions the authorities indicated that no significant changes in the list are envisaged, particularly as they felt that a more broadly based tax on incomes was undesirable in view of the likely decline in real wages, owing to inflationary developments. The authorities undertook nevertheless to adjust petroleum product prices to reflect increases in domestic import costs; accordingly, on February 1, 1988, retail petroleum prices were increased by about 12 percent.

On the expenditure side, current expenditure is projected to rise by 9.6 percent, to reach MK 700 million. The wage bill is projected to rise by only 5 percent, reflecting only the normal wage drift. This will be attained through a freeze on net civil service employment combined with maintaining wage and salary rates unchanged. In real terms wages would be slightly below the level of 1985/86, which preceded the significant across-the-board increases given in 1986/87. Other current expenditure (excluding interest) is projected to rise by about 9 percent to MK 352 million. While this represents a significant reduction in real terms over the 1987/88 outturn, the latter includes the substantial expenditure overruns early in that year. Viewed against estimated developments in the latter half of the year, the 1988/89 budget would represent a modest real increase in these outlays.

Development expenditures, which are mostly foreign financed, are projected to rise by 17 percent to MK 251 million. However, the authorities stressed that they regard the projections as subject to further discussion and possible modification. Discussions are proceeding with donors regarding possible assistance on highly concessional terms in critical areas, particularly possible additional assistance in removing transportation bottlenecks. The level of development expenditure will be reviewed at the time of the first program review, taking account of any highly concessional additional assistance, and including the future recurrent costs and savings as well as debt servicing associated with any additional outlays.

As noted above the 1988/89 budget projections include MK 12.2 million to provide for any net expenditures incurred for the purchase, transportation, or distribution of emergency maize imports. They also

include an amount of MK 6.5 million for the Fertilizer Revolving Fund to cover the projected cost of the subsidy for smallholder purchases of fertilizer during 1987/88. These items will be reviewed in the course of the first program review; for fertilizer, the review will cover the implications of the subsidy policy for subsequent budget outlays.

Development expenditure priorities are reflected in a rolling three-year public sector investment program. Also, the Government is completing a detailed statement of development policies for the decade 1987-96, to be presented at the next meeting of the Consultative Group for Malawi, expected in mid-1988. This program will emphasize improvements in external transport routes and the promotion of private sector activity as critical means to improve Malawi's growth performance. In addition increased emphasis is to be given to enhanced secondary education to improve the effectiveness of social spending. The authorities are also cooperating with the World Bank in reviewing priorities and the allocative efficiency of recurrent outlays. This review will also include ways to safeguard critical outlays for the social sectors.

The authorities are also continuing to pursue fiscal reform efforts. One element of this is reinforcement of the institutional mechanism noted above to improve control of government outlays. An additional element is a broad program of tax reform. This will focus on broadening the tax base; establishing uniform rates of effective domestic protection; distinguishing between taxation for domestic protection for revenue mobilization and redistribution purposes; and tax incentives to encourage production and investment.

3. External sector policies

a. Exchange and trade liberalization

As noted in the attached letter, the authorities intend to liberalize progressively existing quantitative restrictions on the approval of foreign exchange applications with respect to private sector imports. The achievement of this objective will require an active exchange rate policy and other measures aimed at improving export volumes and efficient import substitution, supplemented by prudent debt management policies and by the authorities' request for debt rescheduling. Given that the February 1987 devaluation of the Malawi kwacha was largely eroded by inflationary developments during 1987, on January 16, 1988 the kwacha was further devalued by 15 percent in foreign currency terms against its currency basket. Consequently, petroleum prices have been raised to reflect fully the increased costs in domestic currency terms. The authorities intend to continue to pursue a flexible exchange rate policy throughout the program period, with the aim of maintaining external competitiveness.

In view of existing external imbalances, the low level of reserves, and the degree of uncertainty in this area, import liberalization is

being introduced in a cautious manner. The first stage, introduced effective February 1, 1988, included a list of spare parts and raw materials that will henceforth be imported under open general licensing arrangements. Subsequent policy will focus on remaining raw materials and spare parts, followed by most intermediate and capital goods. The eventual aim will be to move the system to a negative list. The scope of the liberalization of the import approval system will be widened, and the pace of its implementation accelerated, should available foreign exchange exceed present projections. Reaching understandings on the timing and content of subsequent liberalization measures, as well as on exchange rate policy, will be a condition for completing each of the program's reviews.

b. Balance of payments

External policies aim at restoring the growth of export volumes to historic levels by ensuring appropriate incentives. This will be facilitated by the program's exchange rate policy, the benefits of which will be passed on to producers. The authorities are also formulating a package of measures, to be announced around mid-1988, to improve export incentives (within the limits of the program's fiscal policies). However, these improved incentives will have little effect on volumes for 1988, which are expected to decline by about 8 percent, mainly on account of delayed and insufficient rainfalls, expected to adversely affect tobacco output, and the impact of stagnant or declining world prices for other major export crops. Taking account of the liberalization of the import allocation system, import volumes (excluding emergency maize imports) are programmed to rise by 5 percent. The terms of trade are expected to decline slightly, for the fourth consecutive year. The higher projected deficit on the trade account, together with higher payments for services and slightly lower private transfers, is projected to lead to a temporary deterioration of the current account deficit (excluding official transfers and emergency maize imports) to about 7.3 percent of GDP. Projections of the capital account indicate a small further improvement, by SDR 7 million, to about SDR 100 million; however, if grants related to emergency maize imports were excluded, there would be a decline of some SDR 10 million, with the absence of projected short-term capital inflows offsetting higher long-term concessional inflows to Government. As a result, the overall balance of payments is projected to show a small surplus of SDR 1.3 million, compared with a surplus of SDR 52 million in 1987 (Table 7).

With respect to financing, as noted above the Government attaches great importance to the regularization of short-term trade financing arrangements. Accordingly, remaining import-related arrears, which amounted to SDR 17.6 million at end-December 1987, will be reduced to SDR 5.0 million by end-March 1988, and eliminated by end-June 1988 through cash payments. It is also anticipated that the debt service arrears will be eliminated before end-May 1988 in the context of rescheduling agreements; any arrears not rescheduled will be eliminated through cash payments. Satisfactory progress with respect to debt

Table 7. Malawi: Illustrative Balance of Payments Scenario, 1987-92

(In millions of SDRs)

	Est. 1987	Projected 1988	1989	1990	1991	1992
Current account	-41.4	-99.2	-70.7	-69.6	-58.5	-45.7
Trade balance	-6.5	-57.3	-27.3	-28.8	-19.0	-7.4
Exports, f.o.b.	223.8	204.5	226.5	240.4	257.4	276.7
Imports, c.i.f.	-230.3	-261.8	-253.8	-269.3	-276.4	-284.1
Non-maize imports, f.o.b.	-134.8	-141.5	-152.3	-161.6	-171.4	-181.8
C.i.f. margin	-89.9	-94.3	-101.5	-107.7	-105.0	-102.3
Maize imports, c.i.f.	-5.6	-26.0	--	--	--	--
Services & private transfers	-34.9	-42.0	-43.0	-40.7	-39.5	-38.3
Nonfactor services	-13.5	-15.0	-17.3	-16.9	-16.9	-16.9
Receipts	15.4	16.1	17.0	17.9	18.9	19.9
Payments	-28.9	-31.1	-34.3	-34.8	-35.8	-36.9
Factor services	-45.4	-46.5	-46.0	-44.9	-44.4	-44.0
Receipts	2.1	2.4	2.6	2.7	2.8	3.0
Payments	-47.5	-49.0	-48.5	-47.6	-47.2	-47.0
Of which: interest	-40.0	-36.2	-34.8	-33.1	-31.8	-30.6
Private transfers (net)	24.0	19.6	20.3	21.0	21.8	22.7
Capital account	93.3	100.5	88.5	47.7	39.4	30.6
Long-term, net	72.3	100.5	88.5	47.7	39.4	30.6
Government transfers (net)	28.7	60.5	23.6	21.2	22.7	23.0
Of which:						
SAL-related grants	7.0	19.6	2.9	--	--	--
Maize grants	4.4	20.6	--	--	--	--
Government loans	38.1	39.6	62.8	25.1	15.5	7.8
Disbursements 1/	72.[illegible]	81.9	104.0	49.9	39.8	30.5
Of which:						
SAL-related loans	38.5	27.1	42.1	--	--	--
Amortization	-34.4	-42.3	-41.3	-24.8	-24.3	-22.7
Public enterprises	2.4	-1.5	-1.2	-0.9	-0.6	-1.4
Disbursements 1/	9.0	4.5	4.5	4.4	4.5	4.5
Amortization	-6.6	-6.0	-5.7	-5.2	-5.2	-5.9
Private sector (net) 1/	3.1	1.9	3.3	2.2	1.9	1.1
Short-term and unidentified	21.1	--	--	--	--	--
Overall balance	51.9	1.3	18.2	-21.9	-19.1	-15.1
Financing	-51.9	-1.3	-18.2	21.9	19.1	15.1
Official net foreign assets (increase -)	-44.8	-14.3	-36.6	-25.6	-26.9	-20.2
Gross official reserves (increase -)	-19.0	-5.9	-13.1	-5.9	-4.0	-4.8
IMF Purchases	--	11.5	1.5	--	--	--
IMF Repurchases	-23.6	-19.9	-19.0	-13.8	-15.7	-15.5
Change in other liabilities (net)	*0.8*	--	*-6.0*	*-6.0*	*-6.8*	--
Change in arrears	-10.6	-33.2	--	--	--	--
Import related	-26.2	-17.6	--	--	--	--
Debt service related	15.7 2/	-15.7	--	--	--	--
Financing gap 3/	0.4	46.3	18.4	47.5	45.9	35.4
Memorandum items:						
Potential debt relief	0.4 4/	38.9 5/	7.4 5/	--	--	--
Current account (percent of GDP)						
Excluding official transfers and emergency maize imports	-3.6	-7.3	-6.1	-5.5	-4.2	-3.0
Including official transfers	-2.0	-5.8	-4.3	-3.8	-2.6	-1.5
Overall balance before SAL	6.4	-45.4	-26.8	-21.9	-19.1	-15.1
Gross official reserves						
End-period stock	34.7	40.6	53.7	59.5	63.5	68.3
In weeks of non-maize imports, c.i.f.	8.0	9.0	11.0	11.5	12.0	12.5

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

1/ Projected disbursements include existing as well as expected commitments.

2/ Estimated debt service payments to Paris Club creditors and principal payments to London Club creditors which have been suspended since late August 1987 pending Malawi's request for debt rescheduling.

3/ Could be covered, *inter-alia, by debt relief, by inflows under the ESAF or SAF*, by further program inflows from the World Bank and other donors or, if necessary, by a slower buildup of reserves after 1989.

4/ Reschedulings of Dwangwa Sugar Corporation's debt.

5/ Estimates of amounts eligible for rescheduling, excluding debt service in respect of loans contracted with Paris Club creditors after the cut-off date set for Malawi's previous reschedulings (January 1, 1982) but including debt service in respect of previously rescheduled debt.

relief will be a condition for completion of the program's first review. Debt service potentially eligible for rescheduling is estimated at about SDR 39 million, including SDR 10.4 million already in arrears. The projected relief is expected to reduce the debt service ratio to about 37 percent, compared with 50 percent without debt relief. To minimize the burden of future debt service payments, the program includes, as performance criteria, limits on new external borrowing of up to 12 years' maturity, as specified in Section 6 below.

Taking account of the above developments, together with net repayments to the Fund and the targeted increase in gross official reserves to an equivalent of nine weeks of non-maize imports, there would be a financing gap of SDR 46. 3 million for 1988. This is expected to be covered by debt relief, by resources under a possible ESAF or SAF arrangement (preliminary discussions for which have already started), by further program inflows from the World Bank and other donors, or, if necessary, by a slower buildup of reserves. More detailed projections and policies for 1989 will be developed during the program's reviews, and in the context of the policy framework paper, which the authorities hope to finalize with the Fund around May 1988.

4. <u>Money and credit policies</u>

The program's monetary targets, and ceilings on net domestic assets of the banking system and on credit expansion have been formulated to be consistent with the program's domestic and external objectives. Net domestic assets of the banking system will rise by 9.9 percent during 1988, with an increase of only 1.9 percent for the fiscal year 1988/89. This reflects a sharp increase in the domestic counterpart of debt relief, from MK 49 million at end-1987 to a projected MK 165 million at end 1988 and MK 192 million by end-March 1989, as these deposits will continue to be sterilized by the Reserve Bank. An increase in net domestic credit of MK 157 million, or 21.9 percent, is programmed for 1988, and MK 105 million, or 13.3 percent for 1988/89. Consistent with the program's fiscal policies, net credit to Government is programmed to rise by MK 61 million, or 12.4 percent, and MK 60 million, or 11.7 percent, for 1988 and FY 1988/89, respectively. Net credit to statutory bodies will rise sharply in 1988 by MK 49 million as the high levels of deposits, of a temporary nature, recorded at end-1987, are drawn down to more normal levels. In 1988/89 net credit to statutory bodies will be virtually unchanged. For credit to the private sector, increases of 23.2 percent and 17.5 percent are programmed for 1988 and for 1988/89, or MK 48 million and MK 42 million, respectively. Despite the increase in the domestic price of imported inputs and the anticipated improvement in output, the programmed increase is felt to be adequate in view of the substantial buildup of company liquidity in 1987. Taking account of the projected balance of payments surplus, the program's exchange rate policy, and the anticipated level of debt relief, the program provides for growth in broad money of 21 percent and 16 percent for 19[illegible] and 1988/89 respectively, which is estimated to be consistent with the program's objective of containing inflation. As noted in Section 6

below, quarterly targets on the net domestic assets of the banking system, on net credit to Government, and on net credit to statutory bodies, will constitute performance criteria. The targets on net domestic assets and on net credit to Government would be automatically adjusted downward, should specified external cash loans and grants exceed programmed amounts.

With respect to interest rate policy, as noted above commercial banks have substantial excess liquidity, combined with slack loan demand, on account of the tight foreign exchange position and weakness of output. In consequence, commercial banks are presently not accepting deposits of more than six months' maturity pending a significant increase in the demand for loanable funds. In these circumstances, the authorities argued that any increase in interest rates would not be appropriate. However, company deposits are likely to be run down and the demand for loanable funds to increase, particularly in response to import liberalization. In these circumstances, interest rate policy will need to be kept under continuous review; reaching understandings on interest rates will therefore be a condition for completion of each of the program's reviews.

5. Structural policies

a. Statutory bodies

An essential part of the reform efforts involves continuation of the structural reforms with respect to statutory bodies, in cooperation with the World Bank and other donors. For ADMARC this will focus on further efforts to improve management and efficiency, and to lower overhead costs; further divestiture of assets will also be undertaken. Projections of ADMARC's 1988/89 budget are for an improvement in the profit on crop trading accounts from MK 2.5 million to MK 4.4 million. Within this total, however, losses are still anticipated for maize, owing mainly to high overhead costs combined with relatively low domestic purchases, and for groundnuts, owing to anticipated depressed world prices. ADMARC's overall loss will be reduced from MK 4.6 million to MK 2.3 million, reflecting mainly continued high net interest charges. The budget provides for prompt payment of obligations falling due to the Government and to the Reserve Bank. Reaching understandings on ADMARC's budget for 1988/89 will be a condition for completion of the first review.

With respect to other statutory bodies, efforts will focus on further improvements in financial performance and efficiency and in improving the oversight functions of the Department of Statutory Bodies. With respect to the former, the nine major parastatals (excluding ADMARC) are provisionally budgeted to improve their net profit performance, from MK 7.8 milion in 1987/88 to MK 20.9 million for 1988/89, reflecting significant further tariff increases, as well as improved management and strict control of costs. In particular, wage bills will be contained through tight control of net employment and no

increase in general wage rates. Aggregate gross investment of the Statutory Bodies is projected to rise sharply in 1988/89, by about MK 30 million, with most of the increase being for ESCOM, reflecting largely foreign-financed investment in improved electrification and power transmission.

Regarding the Department of Statutory Bodies, efforts are focusing on improvements in their monitoring and analysis of parastatal performance and assistance in the evaluation of investment plans and projects, particularly with regard to the impact of these decisions on government and parastatal recurrent costs and future debt service.

b. Agriculture

Agricultural policy will continue to focus predominantly on reliance on market pricing. For most exports, producers receive the actual export price; for those crops for which administered prices apply, mainly smallholder tobacco and groundnuts, these will continue to be guided by developments in world markets. Reflecting world price expectation, unchanged producer prices have already been announced for the 1988 season for these two crops.

With respect to domestic food crops the major concern will be to ensure adequate domestic supplies of maize. To boost production the producer price for 1988 has been raised by 36 percent while, as noted, the price for the major competing crop will be unchanged (for the third consecutive year). In addition, the authorities plan to continue the subsidy for fertilizer (within the program's fiscal objectives) in order to continue to encourage planting of higher-yield hybrid maize varieties. The producer and consumer prices for maize, as well as the retail price of fertilizer, will be reviewed during the year, and if necessary, further increases in these prices will be implemented.

c. Transportation

The objective in this area will be to reduce the c.i.f. margin on imports from 40 percent to 36 percent by 1991/92, which would have a roughly equivalent impact on net export receipts. The objective seems attainable in view of the possibilities for shifting traffic from the high-cost southern route to the lower-cost Nacala and Northern Corridor routes, each of which could carry some 25 percent of Malawi's total trade with an estimated saving of some 25 percent in unit costs. However, developments in this area are also uncertain. For the Nacala rail line, developments will be substantially affected by regional political and security developments. For the Northern Corridor route, substantial assistance has already been received for the necessary improvements of the road, rail, and port facilities in Malawi and in Tanzania. However progress will be determined by the timing and extent of donor disbursements and the efficiency of project implementation.

6. Performance criteria and reviews

The program's performance criteria are shown in Table 8. The table lists the following quantitative performance criteria for end-March 1988 and end-June 1988: (a) limits on net domestic assets of the banking system; (b) limits on net claims on Government by the banking system; (c) limits on net claims on statutory bodies by the banking system; (d) elimination of existing external payments arrears and no accumulation of new external payments arrears except, until end-May 1988, for payments due to Paris and London Club creditors pending consideration of Malawi's request for rescheduling; (e) limits on new nonconcessional external loans contracted or guaranteed by the Government and other public sector institutions; and (f) limits on the net increase in short-term external debt contracted or guaranteed by the Government and other public sector institutions of less than one-year maturity. The figures listed for end-September 1988, end-December 1988, and end-March 1989 are indicative limits; performance criteria for these dates will be established at the time of the first review.

There will be two reviews with the Fund, to be completed by end-June 1988 and end-December 1988, respectively. The first review will focus on the 1988/89 budget of the Central Government and of ADMARC, exchange rate policy, interest rate policy, further import liberalization, developments with respect to Malawi's request for debt rescheduling, developments with regard to domestic food supplies and policies with respect to the fertilizer subsidy. The second review is expected to focus on exchange rate and interest policies, as well as import liberalization. Completion of each of these reviews shall constitute a performance criterion under the stand-by arrangement. In addition, the program includes the standard performance criterion regarding the exchange and payments system.

V. The Medium-Term Outlook

Malawi's external position will remain difficult, and substantial external assistance will continue to be needed over the next few years. This will require that adjustment and structural reform measures be vigorously pursued and implemented throughout the period. On the basis of the latest staff projections, as shown in Table 7, there would be financing gaps of SDR 46.3 million and SDR 18.4 million for 1988 and 1989 respectively, rising to SDR 47.5 million in 1990, as no further program inflows from the World Bank are included beyond those presently in process, which will be disbursed before end-1989. The gap declines to SDR 35 million by 1992, and would continue to fall thereafter, particularly as repurchases to the Fund would have been largely completed. These financing gaps should be manageable, taking account of resource inflows that could be available to Malawi from debt relief and under the ESAF or SAF, as well as possible further program inflows from the World Bank after 1989. Furthermore, the improvement in the external position over the medium term provides for growth of import volumes of

Table 8. Malawi: Proposed Quantitative Performance Criteria and Indicative Targets, March 1988-March 1989

	1987	1988				1989
	Dec.	March 1/	June 1/	Sept. 2/	Dec. 2/	March 2/
		(In millions of Malawi kwacha)				
Net domestic assets of the banking system 3/	590.3	632.5	692.7	715.2	648.8	644.7
Net claims on the Government by the banking system 3/	490.9	508.9	528.3	562.6	551.6	568.9
Net claims on the Statutory Bodies by the banking system	20.6	40.8	61.1	84.9	69.1	43.7
		(In millions of SDRs; end of period)				
External payments arrears	17.6 4/	5.0 4/	—	—	—	—
New nonconcessional loans contracted or guaranteed by the Government and other public sector institutions (cumulative) 5/						
Of which: 1-12 years	(...)	(20.0)	(20.0)	(20.0)	(20.0)	(20.0)
1-5 years	(...)	(—)	(—)	(—)	(—)	(—)
Net increase in short-term external debt contracted or guaranteed by the Government and other public sector institutions of less than one year maturity 6/	...	—	—	—	—	—

Source: Letter of Intent.

1/ Performance criteria.
2/ Indicative targets.
3/ These criteria would be adjusted downward by the amount that disbursements of specified external cash loans and grants exceed MK 49.1 million during December 31, 1987-March 31, 1988 and MK 67.2 million during December 31, 1987-June 30, 1988.
4/ Excludes arrears on debt service for which a request has been made to Paris and London Club creditors for rescheduling. These debt service arrears are required to be eliminated under the program by end-May 1988, either through cash payments or through rescheduling.
5 Excludes arrears on debt service for which a request has been made to Paris Club creditors for rescheduling.
6/ Excludes short-term trade finance.

about 4.5 percent in 1988 and 3 percent per year during 1989-92, consistent with the program's GDP growth target and import liberalization objective.

The projections are based on conservative assumptions for the major variables involved. With respect to the terms of trade, following the deterioration of 21 percent during 1984-87, virtually no change is projected for 1988-90, followed by an improvement of 4 percent in 1991, and in 1992. After a decline of 8 percent projected for 1988, export volumes are forecast to rise by about 4.5 percent per annum in response to improved incentives. With respect to external transportation, in view of the uncertainties involved, the projections assume that the 40 percent c.i.f. margin will remain in effect until 1990, before declining to 38 percent for 1991, and 36 percent for 1992. These developments will enable the current account deficit to be reduced steadily, to about 3 percent of GDP by 1992. A tentative medium-term macroeconomic scenario, consistent with the reduced current account deficit, indicates that to allow for a progressive recovery of private investment throughout the period, the government budget deficit will need to decline to about 5 percent of GDP by 1992.

Based on conservative assumptions for inflows from the World Bank, which include only loans in place or in process, and for other multilateral and bilateral donors, the long-term capital account will show a declining surplus over the medium term, from about SDR 100 million in 1988 to SDR 31 million in 1992. These capital account balances, together with the program's assumptions and policies with respect to debt rescheduling, clearance of arrears, and net use of Fund resources are consistent with a gradual increase in reserves, to some 12 weeks of imports by end-1992.

It is assumed that external inflows to Malawi will be predominantly on highly concessional terms, leading to steady improvement in Malawi's debt profile. This objective will be reinforced by the program's ceilings on the contraction or guarantee of debt by the Government and other public sector institutions. The stock of debt is envisaged to increase from SDR 865 million (86 percent of GDP) at end-1987 to SDR 1.1 billion (72 percent of GDP) by end-1992. However, total debt service payments are projected to decline from SDR 110 million in 1987 to SDR 84 million in 1992; as a ratio to exports of goods and nonfactor services, this represents a decrease from 46 percent to 28 percent for the same period (Table 9).

VI. Staff Appraisal

Following many years of successful growth performance, imbalances have emerged in the Malawian economy, owing to a combination of adverse external circustances compounded by excessively expansionary domestic policies and weaknesses in government and other public sector financial management. In combination, these developments led, in 1986, to the

Table 9. Malawi: Public External Debt and Debt Service, 1983-92

	1983	1984	1985	1986	Est. 1987	Projected 1988	1989	1990	1991	1992
	(In millions of SDRs)									
Total disbursed outstanding 1/	778.4	870.0	853.9	845.1	865.1	892.6	949.4	1,009.6	1,056.6	1,084.1
Of which: Debt to IMF 2/	(97.5)	(114.9)	(121.9)	(101.4)	(77.7)	(69.3)	(51.8)	(38.0)	(22.4)	(6.9)
Total debt service 3/	116.4	125.7	121.2	131.3	109.5	110.1	105.9	83.4	84.7	83.6
Principal	84.4	82.4	77.1	86.8	69.5	73.9	71.1	50.3	52.9	52.9
Interest	41.4	43.3	44.1	44.4	40.0	36.2	34.8	33.1	31.8	30.6
Debt service to IMF 2/	17.1	28.9	25.6	25.1	30.3	25.5	23.6	17.3	18.2	16.8
Repurchases	10.3	20.4	16.0	20.6	23.6	19.9	19.0	13.8	15.7	15.5
Charges	6.8	8.5	9.6	4.5	6.7	5.6	4.6	3.5	2.5	1.4
	(Ratios in percent)									
External medium- and long-term debt disbursed outstanding 4/	68.1	73.8	73.7	80.8	86.4	88.6	83.0	79.5	76.7	71.7
Of which: To IMF 2/	8.5	9.8	10.5	9.7	7.8	6.9	4.5	3.0	1.6	0.5
Total debt service 3/5/	49.9	37.6	44.5	56.9	45.8	49.9	43.5	32.3	30.7	28.2
Principal	33.4	24.6	28.3	37.6	29.0	33.5	29.2	19.5	19.1	17.8
Interest	16.4	13.0	16.2	19.3	16.7	16.4	14.3	12.8	11.5	10.3
Debt service to IMF 2/5/	6.8	8.6	9.4	10.9	12.7	11.5	9.7	6.7	6.6	5.7
Repurchases	4.1	6.1	5.9	8.9	9.9	9.0	7.8	5.3	5.7	5.2
Charges	2.7	2.5	3.5	2.0	2.8	2.5	1.9	1.4	0.9	0.5
Memorandum items:										
Debt relief (SDR millions)	55.3	23.0	6.7	2.4	0.4	38.9 6/	7.4 6/	--	--	--
Of which: Arrears rescheduling	(--)	(--)	(--)	(--)	(--)	(10.4) 6/	(--)	(--)	(--)	(--)
Debt service ratio after debt relief 5/	27.9	30.7	42.1	55.9	45.6	37.0	40.4	32.3	30.7	28.2

Sources: Data provided by the Malawian authorities; IBRD Debt Reporting System; IMF Treasurer's Department; and staff estimates and projections.

1/ End of period, public and publicly guaranteed, medium- and long-term external debt.
2/ Excludes the Trust Fund.
3/ Before debt relief. Financing gap not expected to be covered by debt relief is assumed to be serviced on concessional terms, with an average interest rate of 2.3 percent per annum on loans carrying a five-year grace period.
4/ As percent of GDP.
5/ As percent of exports of goods and nonfactor services.
6/ Potential debt relief, as shown in Table 7.

introduction of controls on external private sector payments and to a buildup of external arrears. This situation urgently requires the adoption of adjustment measures to correct the situation and to minimize the long-term detrimental effect on Malawi's productive base.

The authorities recognized the importance of adopting a comprehensive program of adjustment measures. Accordingly, in 1987 a number of actions were taken in the context of discussions with the Fund staff, including exchange rate and interest rate actions and, in August 1987, revenue and expenditure measures to reverse the deterioration in fiscal performance. These actions, however, followed further expenditure overruns in the government budget in the preceding months. Steps have also been initiated, in collaboration with the World Bank, to improve the performance of statutory bodies. Toward the end of the year, a shortfall in domestic food supplies emerged, with potentially serious economic and political implications. The authorities have responded quickly and effectively, requesting external assistance, arranging emergency purchases, and making budgetary provisions, to minimize the adverse impact of the shortfall. The authorities have already implemented actions to improve domestic food production. Developments will need to be closely monitored and further actions taken if needed.

The program now adopted for 1988 and for 1988/89 addresses the problem areas facing Malawi. The staff believes that the fiscal adjustment during the program period is appropriate in view of the expenditure developments in 1987, the inelasticity of the tax system, and the need for emergency food imports. Given the slippages that have occurred in this area in the past, it will be particularly important for the authorities to adhere strictly to the program's targets for government expenditure and the overall deficit. It is to this end that indicative targets will be established for these items at the time of the first program review.

On the external side, the authorities have recently implemented an exchange rate devaluation designed to restore the external competitiveness that was eroded in 1987. Exchange rate policy will need to be closely monitored throughout the program with the aim of maintaining Malawi's external competitiveness. In this context, attainment of the program's target for inflation will be of critical importance. The authorities have also rightly placed great emphasis on regularizing short-term trade credits. They have therefore substantially reduced, and will rapidly eliminate, import-related arrears. They have also settled trade-related short-term external obligations to commercial banks, and have remained fully current on all payments to the Fund during 1986-87. The staff believes that Malawi's economic and financial program adresses the issue of payment arrears in a manner satisfactory to the Fund; under its program for the elimination of external arrears, Malawi has requested debt rescheduling from Paris and London Club creditors, and the staff anticipates an early favorable response to those requests. The total elimination of Malawi's arrears by the end of June 1988 is a condition for completion of the first review under the

arrangement. The above policies are designed to restore the traditional confidence in Malawi of the international and domestic financial and business community. In view of this, it is to be expected that foreign commercial banks will be accommodating in making revolving trade-related credits available as needed. The program's fiscal and external objectives are consistent with the sharp improvement in the private sector balance, following the liberalization of imports. The policies already adopted will need to be reinforced by further progress in import liberalization both during the program period and beyond, consistent with the medium-term balance of payments outlook. A return to regular debt servicing arrangements would be in Malawi's interests by further enhancing international confidence and encouraging capital inflows.

Accordingly, the staff recommends temporary approval, until end-June 1988, of the retentions by Malawi of the exchange restrictions evidenced by the payments arrears and, until end-1988 of the restrictions that would remain pending the reaching of bilateral agreements pursuant to the forthcoming reschedulings under the auspices of the Paris and London Clubs.

In view of the medium-term balance of payments outlook, and the difficult external environment that Malawi will continue to be faced with, a sustained adjustment effort will clearly need to be pursued over the medium term. In this connection, the authorities have indicated their intention to seek, by mid-year, a three-year arrangement under the ESAF. The medium-term adjustment effort will require prudent monetary and credit policies; in particular, the authorities will need to ensure that the growth of net domestic assets is tightly constrained to levels consistent with the targeted reductions in inflation. The present fiscal policy stance will need to be further tightened to allow for a sufficient availability of bank credit to the private sector, which in turn would facilitate the targeted growth of output. Progress in implementation of the tax reform already initiated would assist this objective, and continued tight control on expenditure developments, particularly avoidance of overruns on current expenditure, will be essential to its attainment. Structural reform measures will need to be vigorously pursued over the medium term. Further progress in the reform efforts for statutory bodies, particularly ADMARC, will be an important factor in improving growth prospects and performance. This performance will also be critically dependent on an appropriate external and domestic price structure to ensure appropriate incentives. In this connection, continued flexibility in exchange rate and interest rate policies will be crucial to attainment of the medium-term objectives.

The staff believes that the policies included in the program are appropriate to the circumstances and prospects facing Malawi. However, as in the past, actual developments may be affected to a large extent by external developments beyond the authorities' control, particularly regional political developments that are difficult to anticipate. It will therefore be necessary for the authorities to continue to improve their monitoring and control of the impact of domestic and external

developments on economic and financial aggregates, and, if warranted, to adopt quickly further adjustment measures even beyond those presently envisaged. The authorities are fully aware of the difficulties and uncertainties facing Malawi and will maintain close contact with the staff to ensure that the program is successfully implemented.

It is recommended that the next Article IV consultation with Malawi be held on the standard 12-month cycle.

VII. Proposed Decisions

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

(i) 1987 Consultation

1. The Fund takes this decision relating to Malawi's exchange measures subject to Article VIII, Section 2(a) in concluding the 1987 Article XIV consultation with Malawi and in the light of the Article IV consultation with Malawi conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies), as amended.

2. Malawi maintains the restrictive exchange measures described in SM/88/ , in accordance with Article XIV, Section 2, except that the exchange restrictions evidenced by arrears on commercial payments are subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to take measures to eliminate these arrears as soon as possible. In the meantime, the Fund approves the retention by Malawi of these restrictions, until the earlier of June 30, 1988 or the completion of the first review under the stand-by arrangement, and of any restrictions remaining pending the implementation of bilateral agreements under the Paris and London Clubs' rescheduling or refinancing of Malawi's external debt until December 31, 1988.

Malawi is on the standard 12-month Article IV consultation cycle.

(ii) Request for Stand-By Arrangement

1. The Government of Malawi has requested a stand-by arrangement for the period from March , 1988 to May , 1989, in an amount equivalent to SDR 13.02 million.

2. The Fund approves the stand-by arrangement attached to EBS/88/25.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Malawi - Stand-By Arrangement

Attached hereto is a letter dated February 2, 1988, from the Minister of Finance and the Governor of the Reserve Bank of Malawi requesting a stand-by arrangement and setting forth (a) the objectives and policies that the authorities of Malawi intend to pursue for the period of this stand-by arrangement; and (b) understandings of the Malawian authorities with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Malawi will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from , 1988 to May 30, 1989, Malawi will have the right to make purchases from the Fund in an amount equivalent to SDR 13.02 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of:

SDR 9.250 million until May 15, 1988
SDR 10.004 million until August 15, 1988
SDR 10.758 million until November 15, 1988
SDR 11.512 million until February 15, 1989
SDR 12.266 million until May 1, 1989

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Malawi's currency in the credit tranches beyond 25 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources.

4. Malawi will not make purchases under this stand-by arrangement that would increase the Fund's holding of Malawi's currency in the credit tranche beyond 25 percent of quota:

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the limit on net domestic assets of the banking system, or

(ii) the limit on net claims on the Government by the banking system, or

(iii) the limit on net claims on the statutory bodies by the banking system, or

(iv) the limit on new nonconcessional external loans contracted or guaranteed by the Government and other public sector institutions, or

(v) the limit on the net increase in nonconcessional short-term external borrowing, contracted or guaranteed by the Government and other public sector institutions, or

(vi) the limit on the accumulation of external arrears pending the elimination of the total outstanding stock of external arrears,

as described in paragraph 24 of the attached letter and specified in the table annexed to the attached letter is not observed; or

(b) after June 30, 1988 and December 31, 1988, respectively, until the reviews described in paragraph 24 of the attached letter have been completed and suitable performance criteria have been established, or after such performance criteria have been established, while they are not being observed; or

(c) if Malawi

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Malawi is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Malawi, and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Malawi will not make purchases under this stand-by arrangement during any period of the arrangement in which it has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Malawi's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision by the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Malawi. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Malawi and understandings have been reached regarding the circumstances in which such purchases can be assumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be in SDRs if, on the request of Malawi, the Fund agrees to provide them at the time of the purchase.

8. Malawi shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. (a) Malawi shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Malawi's balance of payments and reserve position improves.

(b) Any reductions in Malawi's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

10. During the period of the stand-by arrangement, Malawi shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Malawi or of representatives of Malawi to the Fund. Malawi shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Malawi in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 25 of the attached letter, Malawi will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government, or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of this stand-by arrangement and while Malawi has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Malawi's balance of payments.

Lilongwe, February 2, 1988

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus,

1. Following a lengthy period of very favorable growth performance, external imbalances began to hinder Malawi's economic performance in the late 1970s. These difficulties relate to external developments, particularly regional political instability, which have exerted pressures on domestic expenditure and on the balance of payments, as well as domestic policy related factors. To address these problems, the Government implemented adjustment programs in the context of successive stand-by arrangements from the Fund, followed by the adoption of a three-year program under the Extended Fund Facility as well as three Structural Adjustment Loans (SAL) with the World Bank. Considerable progress was made in that period, including a large number of measures to address structural problems as well as adjustment of relative prices and incentives, including a more active exchange rate policy. The current account deficit (excluding official transfers) improved from 20.6 percent of GDP in 1980 to 10.9 percent in 1983 and domestic demand pressures were moderated. In 1984 exceptionally favorable conditions resulted in a current account deficit of only 1.4 percent of GDP with substantial reserve accumulation.

2. However, since 1985 economic performance and prospects have been set back as external and domestic financial imbalances have again emerged. In combination with continued adverse external developments, in particular, a further deterioration in transportation routes which has now raised the c.i.f. margin on imports to 40 percent, growth performance and prospects have been sharply reduced. During 1985-86 aggregate domestic demand increased largely reflecting public sector deficits. The central government budget deficit (before grants) rose to 9.6 percent of GDP in 1985/86 (April-March) and reached 12.5 percent of GDP in 1986/87. In part this reflected the cost of building up a strategic food reserve and budgetary pressures related to regional political instability, but it also reflected overruns in expenditure and a decline in the revenue to GDP ratio. Fiscal imbalances were exacerbated by financial difficulties experienced by the parastatal sector, particularly in the area of agricultural marketing.

3. The external financial position also deteriorated markedly, with the external current account deficit rising to 8.2 percent of GDP in 1985 and 6.1 percent in 1986. During this two year period export volumes declined somewhat and there was a sharp deterioration in the

terms of trade. Despite large SAL-related inflows, the overall balance of payments deteriorated from a surplus of SDR 42 million in 1984 to deficits of SDR 46 million and SDR 67 million in 1985 and 1986, respectively. The deteriorating foreign exchange position also increased the relative burden of debt service payments. Although these increased only slightly in nominal terms the debt service ratio rose from 38 percent in 1984 to 57 percent in 1986. While external debt obligations continued to be met in full, quantitative restrictions on the approval of foreign exchange applications with respect to private sector imports were introduced, and external arrears on short-term trade payments emerged. By end-1986 these had reached SDR 44 million, while gross reserves had declined to the equivalent of less than 4 weeks of imports. Inflation rose to 15 percent in 1985-86, compared with an average of 11 percent during 1981-84 and real growth began to decline, falling to 2.2 percent in 1986 compared with an estimated population growth rate of about 3.2 percent.

4. In 1987 a number of actions were introduced to address the deterioration in our domestic and external financial position. These were implemented in consultation with staff of the Fund and the World Bank with whom we maintained close contact during the year. With regard to domestic financial policy, a first step in the adjustment process was taken in August 1987 when a program of fiscal actions was introduced in the context of a "shadow program" prepared with the assistance of the Fund staff. These measures included actions to mobilize revenues and to contain expenditures. In particular, the import duty levy was doubled from 5 percent to 10 percent, taxes on a number of public services were raised, and steps were taken to limit the growth of the civil service wage bill and to strengthen the control and monitoring of government expenditures. Those ministries and departments which previously held their own funds were required to place them in accounts at the Reserve Bank which began to monitor the cash balances of all ministries on a weekly basis. The activities of the Government's expenditure monitoring committee were intensified and were supplemented by a new government import vetting committee. Also, a new policy organ, the National Economic Council, was created to provide a broad platform of support for policy measures. These actions were intended to reduce the deficit then targeted for 1987/88 by the equivalent of 3 percentage points of GDP. Despite some shortfalls in import-related revenues associated mainly with the continuing tight foreign exchange position, the shadow program's objectives were broadly achieved, mainly through the reversal of expansionary expenditure trends that marked the first half of the year. Present estimates indicate that for 1987/88, revenues will rise by 10.3 percent to MK 544 million while expenditure is expected to increase by only 8.1 percent to MK 862 million. In combination, taking account of unidentified items, these developments will constrain the overall deficit (before grants) to MK 323 million, equivalent to 10.7 percent of GDP compared with 12.5 percent for 1986/87.

5. The balance of payments has shown a marked improvement i 1987 although our external financial position remains very tight. .n

February 1987 the Malawi Kwacha was devalued by 20 percent in foreign currency terms against its currency basket. The volume of exports rose by almost 6 percent in 1987, and despite a further deterioration in the terms of trade of 2.4 percent import volumes rose slightly. Although the quantitative restrictions on imports introduced in 1986 had to be retained, a number of actions were taken to give priority to the productive sectors of the economy and to reduce the adverse impact of these resstrictions on the private sector. The balance on services and transfers improved reflecting increased private transfers, and the current account deficit (excluding emergency maize imports) was reduced to 3.6 percent of GDP. The capital account also improved markedly, on a payments due basis, as the large negative movements of short-term capital experienced in 1986 were reversed. The overall 1987 balance of payments showed an estimated surplus of SDR 52 million. Nevertheless, in view of our high debt service ratio and the large proportion of our debt that is due to multilateral institutions and thus not reschedulable, we felt obliged to seek debt relief on all reschedulable debts on account of the continued tight foreign exchange position; in August 1987 we approached the Paris and London Clubs for a comprehensive rescheduling of medium- and long-term commercial bank and bilateral credits. Since that request we have suspended service payments to Paris Club creditors and principal payments to London Club creditors pending consideration of our request. Other debt obligations have continued to be met in full, including repurchases to the Fund of SDR 23.6 million in 1987 and Reserve Bank short-term trade-related commitments to commercial bank creditors of SDR 18.4 million. The overall payments surplus has enabled us to substantially reduce external arrears on short-term trade payments, by SDR 26.2 million, to only SDR 17.6 million at end-1987. We consider rapid progress in the area of regularizing short-term trade financing arrangements essential to the restoration of international confidence in Malawi. We were also able to increase gross reserves to the equivalent of 8 weeks of imports.

6. Regarding monetary and credit developments during 1987, domestic credit declined by 4.9 percent. This reflects the fiscal developments noted above, which resulted in an increase in credit to Government of 7.3 percent, and a fall in credit to statutory bodies and the private sector of 23.7 percent. The latter occurred as company liquidity increased sharply due to the foreign exchange restrictions as well as a profitable season for tobacco exporters. This restraint on credit was reinforced by our interest rate policy. In July 1987, in connection with the "shadow program" interest rates on deposits were increased by 3 percentage points which brought the 12-month deposit rate to 17 percent. At the same time, maximum lending rates were deregulated and base lending rates rose 4 percentage points to 20 percent. Reflecting the increase in company liquidity the money supply is estimated to have risen by 35 percent.

7. A number of actions were also taken to improve the performance of the parastatal sector. Concerning the major parastatal, the Agricultural Development and Marketing Corporation (ADMARC), a package of

structural and cost-cutting reforms was initiated with the assistance of the World Bank. These include rationalization of marketing infrastructure and staffing levels, management reform, and asset restructuring and disposals. Also, in early 1987 actions were taken to encourage private sector participation in marketing smallholder agricultural produce. There was also a wide-range of price and tariff increases which resulted in a marked improvement in the financial performance of the sector. In 1986/87 the 10 major parastatals made a consolidated operating loss of MK 11.3 million; for 1987/88 it is estimated that this will be reversed to a consolidated operating profit of MK 3.2 million, with 9 of the 10 enterprises improving their profit performance.

8. Despite our efforts outlined above, the inflation rate rose to an estimated 26 percent and growth performance fell sharply with real output declining by an estimated 0.4 percent. These developments reflected the external factors noted above as well as the effect of the expansionary fiscal policies pursued in 1985-86 which continued in the early part of 1987. Two additional problems arose during the year which threaten economic performance; there has been a growing influx of displaced persons from Mozambique and there was a poor performance of food crops in 1986/87. Output of maize, the basic staple, has been affected by a deterioration in the producer price relative to competing crops as well as rising input costs and inadequate rains in early 1987. Output of cassava, a complementary crop, has been affected by mealybug disease which is difficult to eradicate. The maize producer price for 1987/88 has been increased by 36 percent, but a significant immediate shortfall in domestic food supplies has emerged on account of the fall in domestic production and the additional demand from displaced persons. We have requested emergency food assistance from the international community.

9. Consequent to the above factors we are implementing an adjustment program covering the 15-month period January 1, 1988-March 31, 1989 in support of which we are hereby requesting from the International Monetary Fund a stand-by arrangement in an amount equivalent to SDR 13.02 million, or 35 percent of Malawi's quota. We recognize that the adjustment effort will need to be continued over the medium-term and we will be submitting, in the near future, a request for a three-year structural adjustment arrangement in the amount that will be available to Malawi under the Enhanced Structural Adjustment Facility (ESAF), and the first annual arrangement thereunder. The program should, therefore, be viewed in terms of the initial stage toward achieving our medium-term objectives. In view of our resource needs, we have also sought and received assurances of continued financial assistance from other major multilateral and bilateral creditors.

10. The basic objectives for the program period and for the medium term are (a) to attain a rate of real growth of 1.5 percent for 1988 after the decline in 1987, and thereafter to achieve annual real growth rates of 3.0-3.5 percent, rising to 4.0-5.0 percent by 1992; (b) to reduce the annual rate of inflation as measured by the consumer price index to at most 20 percent in 1988 and thereafter to achieve a steady reduction to

about 5 percent per annum by 1991-92; and (c) to move steadily toward a sustainable external financial position, consistent with our growth objectives, while removing existing restrictions on current payments and eliminating external payments arrears. To these ends, government policies will place emphasis on restraining aggregate demand to a level compatible with available resources while continuing to place emphasis on removing the structural impediments to economic growth.

11. During 1987 the effect of the February depreciation was largely eroded by inflationary developments during the year and there remains an excess demand for foreign exchange. Accordingly, to restrain relative demand for imports while reinforcing export incentives and facilitating our liberalization objectives, we will continue to pursue a flexible exchange rate policy throughout the program period.

12. In order to achieve a more efficient use of scarce foreign exchange, it is our intention to liberalize progressively existing quantitative restrictions on the approval of foreign exchange applications with respect to private sector imports. In view of the existing low level of reserves, the first stage of liberalization is limited in scope. Subsequent liberalization will focus on remaining raw materials and spare parts, followed by most intermediate and capital goods as well as moving the system eventually to a negative list. Reaching understandings on the timing and content of the next stage of liberalization and on a timetable for liberalizing the remaining imports will be a condition for completing the first and second reviews under the arrangement.

13. An appropriate exchange rate policy will ensure continued adequacy of export incentives and the effect on export unit values, measured in domestic currency, will be passed on to producers. A package of measures to improve export incentives is now being formulated by the Malawi Export Promotion Council, and we expect to include details of the package in our request for an arrangement under the structural adjustment facility. We will ensure that the net cost of the measures to be implemented will be consistent with the program's fiscal objectives. Despite these actions aggregate export volumes are expected to decline by 8 percent in 1988, mainly reflecting a decline of 13 percent for tobacco, which normally accounts for about one-half of total exports. Consistent with overall balance of payments projections, import volumes (excluding emergency maize imports) will rise by about 5 percent and the terms of trade are expected to decline slightly. This, together with higher service payments and slightly lower private transfers, is projected to result in a temporary deterioration of the current account deficit (again excluding emergency maize imports) to 7.3 percent of GDP. However, medium-term projections indicate that this will be reduced to 6.1 percent in 1989 and to 3.0 percent of GDP by 1992. Projections of the capital account for 1988 indicate an increase of SDR 7 million in the net inflow to about SDR 100 million. This assumes program related inflows from the World Bank and related cofinancing totaling SDR 46.7 million. As a result the overall balance of

payments deficit is projected to be about SDR 1 million. However, inflows in below the line financing, including debt relief and use of Fund resources under the stand-by and ESAF or SAF arrangements, are consistent with an increase in reserves to the equivalent of about nine weeks of imports while eliminating external payments arrears. It is anticipated that debt service arrears to Paris and London Club creditors will be eliminated in the context of our request for rescheduling; satisfactory progress in this area will be a condition for completion of the program's first review. Non-rescheduled external arrears will be eliminated through cash payments. Accordingly, external arrears other than for debt service to Paris and London Club creditors which amounted to SDR 17.6 million at end-December 1987, will not exceed SDR 5 million at end-March 1988 and will be eliminated by end-June 1988. Thereafter, no arrears will be allowed to arise.

14. Projections of balance of payments aggregates for 1989 and beyond are consistent with our medium-term objectives of import liberalization together with a growth of import volumes of 4.5 percent in 1989 and 3 percent per annum thereafter, a further increase in reserves in relation to imports, and remaining current on all external payments. In line with these objectives we will pursue a cautious policy regarding new external borrowing on nonconcessional terms contracted or guaranteed by the Government and other public sector institutions. This will be limited to no more than SDR 20 million during the period of the stand-by arrangement for debt of 1-12 year maturity, with no borrowing in the 1-5 year maturity range. Also, no net increase in short-term external debt with a maturity of less than one year will be incurred by the Government and other public sector institutions except for normal trade finance. The maturity and interest rate structure of our debt will improve, reflecting the elimination in 1987 of short-term liabilities of the Reserve Bank as well as the concentration of new inflows in the form of long-term debt at concessional rates under the SAF, World Bank IDA funds and from bilateral donors.

15. During January-March 1988 budgetary developments will be closely monitored to ensure that the 1987/88 outturn is in line with the program estimates and that the projected increase of MK 18.0 million in net credit to Government from the banking system during January-March 1988 is not exceeded. Thereafter, fiscal policy will aim at a further significant reduction in domestic demand pressures while promoting private sector activity. A further sharp reduction in the central government deficit is therefore essential. Accordingly, fiscal policy for 1988/89 will be based on reducing the deficit by a further 2.6 percentage points of GDP to 8.1 percent of GDP, equivalent to MK 293 million. The reaching of understandings with the Fund on the 1988/89 budget, to be introduced effective April 1, 1988 will be a condition for completion of the program's first review. This will also include establishing quarterly indicative targets for government expenditures and for the overall deficit.

16. To achieve these fiscal objectives a number of further actions are being taken to raise the revenue/GDP ratio from 17.9 percent to 18.5 percent and to reduce the expenditure/GDP ratio from 28.4 percent to 26.6 percent. Additional measures are to be introduced at the time of the budget amounting to MK 35 million, giving a total revenue increase of 23.4 percent. A provisional list of measures yielding this amount, including an increase in the surtax rate, in excise taxes, in company and personal taxes, and in licenses and fees, has been agreed with the Fund staff and will be finalized during the first review mission and announced at the time of the approval of the budget by Parliament. Total expenditure in 1988/89 will increase by 11.9 percent to MK 964 million, including a rise of only 9.6 percent for current expenditure representing a reduction in real terms. This curtailment of expenditure reflects no increase in government wage rates, nor any increase in total civil service employment. It also includes all expenditure related to regional political developments. Also, as with the estimates for January-March 1988, it includes provision for additional costs accruing to the budget on account of the shortfall in domestic maize supplies as detailed in paragraph 19 below. It should be noted that the budget provides for the full amount of debt service as due; the kwacha counterpart of government debt service payments subject to rescheduling will be held in a blocked account at the Reserve Bank, and not set against net government credit from the banking system. Development expenditure is projected to increase by 16.9 percent to MK 251 million, most of which will continue to be financed from foreign sources. Priorities and programs in this area have been agreed with the World Bank in the context of a rolling three-year Public Sector Investment Program. This program will place increased emphasis on improving external transport routes and promoting private sector activity as well as enhanced secondary education. In addition, we are in the process of completing a detailed statement of development policies for the decade 1987-96 which will be presented at the next meeting of the Consultative Group for Malawi, expected to take place around May 1988. The level of development expenditures will be reviewed at the time of the first program review. The review will take into account any additional highly concessional funds that may become available to support high priority areas, such as external transportation routes, as well as the debt servicing and future recurrent costs and savings associated with the expenditure. Based on projections of net foreign financing in the form of grants and loans, which is expected to increase slightly to MK 213 million, and taking account of the anticipated level of nonbank financing, the above fiscal targets are consistent with government borrowing from the domestic banking system of MK 60 million, slightly below the amount provided for 1987/88 and consistent with the program's monetary policies as outlined in paragraph 22 below.

17. We have also initiated a program aimed at fiscal reform through broadening the tax base and improving the effectiveness and efficiency of tax policy, and also further improving the control, monitoring and allocative efficiency of government expenditure. Both elements of tax reform are being undertaken in close cooperation with the World Bank

20. With respect to the parastatal sector some reorganization measures have already been instituted; as noted above the 10 major parastatals improved their aggregate financial position markedly to an operating profit of MK 3.2 million for 1987/88. For 1988/89 a further improvement to MK 18.6 million is budgeted. Based on these projections Statutory Bodies would need little recourse to bank credit during 1988/89 after allowing for full and prompt settlement of all obligations to Government and to the Reserve Bank. This reflects further tariff increases to cover cost increases and to enable most enterprises to maintain their contributions to capital spending, as well as restraint on wage bills through restrictive employment policies and no general increase in wage rates during 1988. Efforts are also continuing to improve management and efficiency in all major enterprises in cooperation with the World Bank. In particular, ADMARC will continue the implemention of the structural reforms initiated in 1987 and has provisionally budgeted an overall surplus of MK 11.5 million for 1988/89. Reaching understandings on *ADMARC's 1988/89 budget will be a condition for completion of the* program's first review. In addition, efforts are being made to strengthen the operations, and monitoring and control functions of the Department of Statutory Bodies. In this, long-term consultants have already been provided by the World Bank, UNDP and ODA (UK).

21. The major structural problem facing the economy remains the external transportation bottlenecks, which have raised the c.i.f margin on imports to 40 percent, compared with 35 percent in 1982 and only 22 percent in the late 1970s. Our objective is to reduce the c.i.f. margin on imports to 36 percent by 1991/92. To this end, investment is continuing on the Northern Corridor through Tanzania which could eventually carry some 25 percent of our trade at a cost saving of 25 percent over the presently dominant Southern route. Substantial assistance has been committed by the U.S., Germany and the U.K. for improvement of the road, rail, and port facilities in Malawi and Tanzania. Following investment in rehabilitation of the line and the rolling stock, the Nacala route, which is Malawi's most direct and lowest cost routing, recently reopened and it is planned to gradually increase traffic as well as to further rehabilitate the facilities with the aim of increasing traffic toward historic levels of 20-25 percent of Malawi's trade. However, progress in this area will depend largely on regional security developments.

22. The program's monetary targets and policies are consistent with the program's overall objectives. Net domestic assets of the banking system will rise by 9.9 percent during 1988; on a fiscal year basis (end-March 1988-end-March 1989) an increase of 1.9 percent is targeted. The increase in domestic credit will amount to 21.9 percent for 1988 and 13.3 percent for 1988/89 reflecting the program's fiscal policy as detailed above, a small increase in credit to Statutory Bodies reflecting their improved profit position, and programed increases in credit to the private sector of 23.2 percent and 17.5 percent for 1988 and 1988/89 respectively. The latter is felt to be adequate in view of the substantial liquid positions built up by companies during 1987.

Taking account of the projected balance of payments surplus the program provides for a growth in money supply of 21 percent and 16 percent during 1988 and 1988/89, respectively, which is consistent with the program's objective of constraining inflation. Quarterly targets on the net domestic assets of the banking system, on net credit to Government and on net credit to Statutory Bodies, as listed in Attachment I, will constitute performance criteria. The targets on net domestic assets and on net credit to Government would be automatically adjusted downward should specified external cash loans and grants exceed programed amounts.

23. Regarding interest rates, following the increase effected in 1987 and the build-up of company liquidity, commercial banks have substantial excess liquidity; liquidity ratios have been running at more than double the legal requirement of 30 percent. Furthermore, banks are presently not accepting deposits of more than 6 months' maturity pending a substantial increase in demand for loanable funds. However, we expect company deposits to be quickly run down in line with the program's external policies, as demand for loanable funds increases. In these circumstances interest rate policy will need to be kept under continuous review. Reaching understandings on interest rate policies will be a condition for completion of the program's reviews.

24. As indicated above and shown in detail in the attached table the following quantitative performance criteria will apply for end-March 1988, and end-June 1988: (a) limits on net domestic assets of the banking system; (b) limits on net claims on Government by the banking system; (c) limits on net claims on Statutory Bodies by the banking system; (d) elimination of existing external payments arrears and no accumulation of new external payments arrears except, until end-May 1988, for payments due to Paris and London Club creditors pending our request for rescheduling; (e) limits on new nonconcessional external loans contracted or guaranteed by the Government and other public sector institutions; and (f) limits on the net increase in short-term external debt of less than one-year maturity contracted or guaranteed by the Government and other public sector institutions. The figures listed in the attached table for end-September 1988, end-December 1988 and end-March 1989 are indicative limits, performance criteria for these dates will be established at the time of the first review. In addition, there will be two reviews with the Fund, to be completed by end-June 1988 and end-December 1988 respectively. Completion of each of these reviews shall constitute a performance criterion of the program. In addition, the program will include the standard performance criteria regarding the exchange and payments system.

25. The Government of Malawi believes that the policies and measures described above are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund on such consultations. In particular, the Government will

reach detailed understandings with the Fund on any further measures that may be needed, including the establishment of suitable performance criteria, in the context of the above mentioned reviews under the arrangement.

Yours sincerely,

S. Chimwemwe Hara
Governor
Reserve Bank of Malawi

L.J. Chimango, M.P.
Minister of Finance
Government of Malawi

MALAWI - Relations with the Fund
(At December 31, 1987)

(Amounts in millions of SDRs, unless otherwise specified)

I. Membership status

a.	Date of membership:	July 19, 1965
b.	Status:	Article XIV

A. Financial Relations

II. General Department

a. Quota: 37.2

	Millions of SDRs	Percent of quota
b. Total Fund holdings of Malawi kwacha	112.74	303.08
c. Fund credit	80.81	217.20
Of which: under stand-by arrangement		
ordinary resources	0.43	1.16
borrowed resources	7.69	20.68
SFF	2.34	6.30
enlarged access	5.35	14.38
under extended arrangement		
ordinary resources	18.53	49.80
enlarged access	37.50	100.80
compensatory financing facility	13.60	36.56
d. Reserve tranche	2.20	5.92

III. Current and previous arrangements and special facilities

	Date of arrangement	Duration (months)	Total amount	Utilization
a. Previous arrangments				
Stand-by	Oct. 1979	30 1/	26.3	5.5
Stand-by	May 1980	24	49.9	40.0
Stand-by	August 1982	12	22.0	22.0
Extended arrangement	Sept. 1983	36	81.0 2/	57.0

1/ Arrangement canceled after 7 months.
2/ Reduced from the original amount of SDR 100 million (EBM/85/77, 5/22/85).

MALAWI - Relations with the Fund (continued)

	Date of purchase	Total amount
b. Special facilities		
Compensatory financing (exports)	Aug. 1979	9.5
Compensatory financing (exports)	Nov. 1979	8.0
	Dec. 1979	1.5
Compensatory financing (cereals)	Sept. 1981	12.0
Buffer stock financing	Dec. 1982	0.9
Compensatory financing (exports)	Mar. 1983	12.2
Compensatory financing (exports)	Aug. 1984	13.8

	Amount	Percent of allocation
IV. SDR Department		
a. Net cumulative allocation	10.98	100.0
b. Holdings	--	--

	Amount
V. Administered accounts	
a. Trust Fund loans	
(i) Disbursed	14.66
(ii) Outstanding	4.69
b. SFF Subsidy Account	
(i) Donation	--
(ii) Loans	--
(iii) Payments by Fund	4.09

VI. Financial obligations due to the Fund

	Overdue Financial Obligations (12/31/87)	Principal and Interest Due 1988	1989	1990	1991
Principal	--	22.4	20.7	14.2	11.8
Repurchases	--	19.9	19.0	13.8	11.7
Trust Fund Repayments	--	2.5	1.7	0.5	0.1
Charges and interest including SDR and TF (provisional)	--	5.7	4.4	3.2	2.2
Total	--	28.1	25.1	17.4	14.0

MALAWI - Relations with the Fund (continued)

B. Nonfinancial Relations

VII. Exchange rate arrangement

The Malawi kwacha is pegged to an unannounced basket of currencies. The intervention currency is the U.S. dollar, for which the Reserve Bank of Malawi's rates are based on the U.S. dollar/SDR rate calculated by the Fund for the preceding day. The rate on December 31, 1987, was MK 1 = US$0.4777.

VIII. Last Article IV Consultation

The last Article IV consultation discussions were conducted during May 27-June 8, 1986, with additional discussions during September 10-13, October 2-8, and October 28-November 8. The staff report for the 1986 Article IV consultation (SM/86/299) was discussed by the Executive Board on January 5, 1987, and the following decision was adopted:

1. The Fund takes this decision relating to Malawi's exchange measures subject to Article VIII, Section 2(a) in concluding the 1986 Article XIV consultation with Malawi and in the light of the Article IV consultation with Malawi conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Malawi maintains the restrictive exchange measures described in SM/86/226, in accordance with Article XIV, Section 2, except that the exchange restrictions evidenced by arrears on commercial payments are subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to take measures to eliminate these arrears as soon as possible.

Malawi is on the standard 12-month Article IV consultation cycle.

IX. Technical Assistance, 1983-86

1. CBD
   a. Training Advisor to the Reserve Bank of Malawi, 1982-84.

   b. Consultant on external debt, three weeks in March-April 1984.

   c. Consultant on the computerization of Reserve Bank operations: approximately six months from March 1985.

MALAWI - Relations with the Fund (concluded)

d. Administrative Advisor to the Reserve Bank; 12 months from June 1986.

2. FAD: Budget Advisor to the Ministry of Finance, July 1985-July 1986.

3. STAT: Technical assistance in the area of money and banking statistics, November 23-December 8, 1983.

Technical assistance in the area of general economic data, October 13-24, 1986.

X. Resident Representative/Advisor

None.

MALAWI - Relations with the World Bank Group

Over the past 21 years, Malawi has received 38 IDA credits and one Special Fund credit, totaling about US$549 million, and 10 Bank loans totaling US$124 million, of which 2 were on third-window terms. Malawi has also received two African Facility Credits totaling US$50.0 million equivalent. Of Bank Group assistance, some US$182 million (25 percent) was for agriculture, US$135 million (19 percent) for education, US$114 million (16 percent) for roads, US$178 million (25 percent) for structural adjustment, US$39 million (5 percent) for power, US$31 million (4 percent) for water, US$18 million (2 percent) for health, and the balance of US$28 million (5 percent) for development finance, technical assistance, and urban housing.

For fiscal year 1987, the following credits were approved: a US$20.0 million equivalent for the Second Lilongwe Water Supply Project, a First Education Sector Credit ($27.0 million), a Second Family Health/Population Project ($11.0 million), a smallholder Agricultural Credit Project ($5.9 million), and a US$10.0 million SAL III supplemental credit from the African Facility. Additional lending operations are planned in industry, transport, education, and agriculture.

IFC's equity participations and lending commitments in Malawi total about US$27.9 million and include investments in textiles, sugar, a development finance corporation (INDEBANK), tourism, the manufacture of alcohol from molasses, and a leasing and finance company. In addition, a US$40.5 million equity subscription and US$3.2 million loan investment in the Viphya Plywoods and Allied Industries United were approved in August 1984 and August 1986.

Malawi: Schedule of Purchases During Period of Stand-by Arrangement, March 1988-May 1989

Amount	Schedule availability	Conditions necessary for purchase 1/
SDR 9.250 million	March , 1988	Board approval of program
SDR 0.754 million	After May 15, 1988	Compliance with quantitative performance criteria as of March 31, 1988
SDR 0.754 million	After August 15, 1988	Compliance with quantitative performance criteria as of June 30, 1988 and completion of the first program review
SDR 0.754 million	After November 15, 1988	Compliance with quantitative performance criteria as of September 30, 1988
SDR 0.754 million	After February 15, 1989	Compliance with quantitative performance criteria as of December 31, 1988 and the completion of the second program review
SDR 0.754 million	After May 1, 1989	Compliance with quantitative performance criteria as of March 31, 1989

1/ Other than generally applicable conditions under the arrangement and nonquantitative performance criteria (including the performance clause on the exchange and trade system).

MALAWI - Statistical Issues

1. Outstanding statistical issues

a. Government finance

Annual and quarterly data published in the IFS cover consolidated operations of the current and development budgets through the first quarter of 1987. These data do not appear to have been derived in accordance with the methodology set forth in the Fund's A Manual on Government Finance Statistics

Data published in the 1987 GFS Yearbook cover the same operations through 1985 and have been derived in accordance with the methodology prescribed by the Manual. It would be useful if the IFS correspondent could restate the data for the IFS using the derivation table published in the GFS Yearbook.

In addition, the last local government data pertain to 1981, and an update would be appreciated.

Furthermore, although the 1987 GFS Yearbook publishes provisional data for many countries, it does not do so for Malawi. The availability of these provisional data, even if they must include some estimates or projections, is very useful for purposes of analysis and policy determination. It would, therefore, be very helpful to encourage production of such data for Malawi for both 1986 and 1987, particularly for major components, on the same basis and with the same coverage as for previous years. This would add appreciably to the usefulness of government finance data for Malawi in the GFS Yearbook.

b. Monetary statistics

Data on other banking institutions have been affected by reporting problems of the Post Office Savings Bank and therefore the Reserve Bank has decided to suspend updating of its own banking survey; this has the effect of delaying the implementation of a banking survey in the IFS in the foreseeable future.

c. Balance of payments

Malawi has not reported balance of payments data to the Bureau of Statistics since 1984. The latest data in the Bureau files relate to 1982. The recent Article IV consultation mission determined that provisional and summary data for 1983-86 were published by the National Statistics Office in the supplement to the June 1987 Monthly Statistical Bulletin. The Bureau of Statistics is reviewing these data for possible inclusion in the Economic Information System.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Malawi in the January 1988 issue of the IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Commissioner for Census and Statistics, Ministry of Finance, and the Bank of Malawi, which, during the past year, have not been provided.

Status of IFS Data

		Latest data in January 1988 IFS
Real Sector	- National Accounts	1986
	- Prices	April 1987
	- Production	April 1987
	- Employment	n.a.
	- Earnings	n.a.
Government Finances	- Deficit/Surplus	Q1 1987
	- Financing	Q4 1986
	- Debt	1984
Monetary Accounts	- Monetary Authorities	July 1987
	- Deposit Money Banks	July 1987
	- Post Office Savings Bank and Building Societies	September 1985
	- Insurance Companies	March 1986
Interest Rates	- Discount Rate	July 1987
	- Money Market Rate	July 1987
	- Bank Lending/Deposit Rate	July 1987
	- Bond Yields	n.a.
External Sector	- Merchandise Trade:	
	Values	July 1987
	Prices: Unit values	Q3 1986
	- Balance of Payments	1982
	- International Reserves	November 1987
	- Exchange Rates	November 1987

MALAWI - Basic Data

Area, population and GDP per capita

Area	118,500 square kilometers
Population: Total (1986)	7.30 million
Growth rate	3.2 percent
GDP per capita (1986)	SDR 143

	1983	1984	1985	1986	1987 Est.
Gross domestic product (at 1978 factor cost)	(In percent of total, except where stated)				
Total (in millions of Malawi kwacha)	770.7	805.1	838.7	856.9	853.7
Agriculture	37.6	38.1	36.7	36.4	37.1
Manufacturing	12.7	12.5	12.1	11.8	11.7
Government	12.0	12.6	12.7	12.8	12.8
Other	37.7	36.8	38.5	39.0	38.4
Annual real rate of growth (percentage change)	3.5	4.5	4.2	2.2	-0.4
GDP at current market prices					
Total (in millions of Malawi kwacha)	1,435.9	1,706.9	2,021.7	2,284.3	2,873.4
Domestic expenditure	107.6	98.1	104.6	102.5	101.9
Private consumption	77.4	69.3	74.8	73.8	74.5
Public consumption	16.4	15.7	17.0	17.6	16.1
Gross fixed capital formation	13.7	13.1	12.8	11.1	11.5
Imports of goods and nonfactor services	28.4	26.4	28.1	24.5	25.8
Exports of goods and nonfactor services	20.8	28.4	23.5	22.0	23.9
Central government finance 1/	(In millions of Malawi kwacha)				
Revenue	286.0	353.3	442.1	492.9	543.9
Total expenditure	432.0	503.2	643.5	797.0	861.6
Recurrent expenditure	(289.1)	(364.8)	(457.3)	(560.5)	(639.2)
Development expenditure	(142.9)	(138.4)	(160.2)	(189.8)	(215.0)
Overall deficit (excluding grants)	-146.0	-149.9	-201.5	-304.1	-322.8 2/
Foreign grants	33.7	40.5	44.8	79.3	106.2
Overall deficit (including grants)	-112.3	-109.4	-156.7	-224.8	-216.6
Financing	112.3	109.4	156.7	224.8	216.6
Foreign (net)	95.0	53.0	51.8	115.0	103.6
Domestic (net)	17.3	56.4	104.9	109.8	113.0
Of which: banking system	(6.1)	(10.0)	(72.4)	(60.9)	(76.8)

MALAWI - Basic Data (continued)

	1983	1984	1985	1986	1987 Est.
Money and credit (end of period) 1/	(Annual percentage change)				
Net domestic assets	13.2	-0.1	18.4	5.9	3.9
Domestic credit (net)	3.0	10.9	20.8	2.8	14.1
Government (net)	2.8	33.6 3/	24.2	16.4	17.8
Statutory bodies (net)	-78.9	382.6	78.3	-73.1	213.6
Private sector	16.9	-19.3 3/	5.7	4.2	--
Money plus quasi-money	0.6	39.6	-3.5	20.6	45.0
Prices					
GDP deflator	11.2	12.8	13.5	12.6	26.2
Urban consumer prices	12.4	12.4	14.9	14.8	26.2
Export price index 4/	-0.7	7.5	-16.8	-16.6	-0.1
Import price index 4/	--	9.0	-4.1	10.9	2.4
Terms of trade	-0.7	-1.4	-13.2	-6.4	-2.4
Balance of payments	(In millions of SDRs)				
Exports, f.o.b.	230.3	308.0	246.2	211.6	223.8
Imports, c.i.f.	-289.9	-263.3	-282.5	-218.9	-230.8
Of which: freight and insurance	(-100.9)	(-105.3)	(-113.1)	(-87.6)	(-89.9)
Trade balance	-58.7	44.7	-36.3	-7.3	-6.5
Services and private transfers (net)	-66.2	-60.9	-59.0	-56.6	-34.9
Current account balance 5/	-124.9	-16.2	-95.3	-63.3	-41.4
Capital account (including net errors and omission)	42.5	58.4	49.6	-3.2	93.3
Overall balance	-82.3	42.2	-45.7	-67.0	51.9
Gross official foreign reserves	12.8	58.0	39.8	15.7	24.0
In weeks of imports	2.3	11.5	7.3	3.7	8.0
External debt					
Disbursed and outstanding					
Including Fund credit	778.4	870.0	853.9	845.1	865.1
Excluding Fund credit	680.9	755.1	732.0	743.7	787.4
Debt service ratio 6/					
Including Fund credit	49.9	37.6	44.5	56.9	45.8
Excluding Fund credit	43.1	29.0	35.1	46.0	33.1

MALAWI - Basic Data (concluded)

Social and demographic indicators 7/

Population density (1986)	62 per square km
Population characteristics (1985)	
Life expectancy at birth	45
Infant mortality (aged under 1, percent)	156
Child death rate (aged 1-4, percent)	35
Health (1981)	
Population per physician	53,000
Population per nurse	2,980
Education (1984)	
Primary school enrollment (percent)	62
Secondary school enrollment (percent)	4

1/ Fiscal year starting April 1 of year indicated.
2/ Includes errors and omissions of MK 5.1 million.
3/ Reflects the assumption by Government of the Press group's debt to the commercial banks and the reclassification of blocked government deposits. If adjusted to an equivalent basis with previous years, the change in net credit to Government and credit to the private sector was 4.5 percent and 0.7 percent, respectively.
4/ In SDR terms.
5/ Excluding official transfers.
6/ Debt service as a percentage of exports of goods and nonfactor services, before debt relief.
7/ Source: World Development Report, 1987, IBRD.