

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

**FOR
AGENDA**

EBS/85/101
Correction 1

CONFIDENTIAL

May 17, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Malawi - Staff Report for the 1985 Article IV Consultation
and Review Under Extended Arrangement

The following corrections have been made in EBS/85/101 (4/24/85):

Page 3, line 4: for "last of these" read "last two of these"

Page 20, last para., line 11: for "after 1984" read "after 1986"

Draft decisions:

Page 33, first heading: for "Article IV Consultation"
read "1985 Consultation"

item 2, line 3: for "SM/85/ ." read "SM/85/121."

Page 34, last line: for "SDR 41 million." read "SDR 34 million."

Page 35, last line: for "February 15, 1985."
read "February 15, 1986."

Corrected pages are attached.

Att: (5)

after completion of the review and establishment of performance criteria for 1985/86. Four further purchases each of SDR 8 million would be available subject to the observance of the performance criteria for June, September and December 1985, and March 1986. The last two of these would also require the reaching of understandings on policies relating to the 1986/87 fiscal year. A final purchase of SDR 8 million would be available after observance of performance criteria for June 1986. Such utilization would raise Fund credit to Malawi to 293.0 percent of quota by the end of the arrangement excluding special facilities (354.3 percent of quota including special facilities).

Relations with the World Bank and a statement by the Bank staff on Malawi's economic policies are contained in Appendix III.

II. Recent Developments and Performance Under the Extended Arrangement

The objectives of the extended arrangement were to establish a balance of payments sustainable in the medium term, while restoring an average annual rate of economic growth of 3.5 percent and reducing the rate of domestic inflation to about 7-8 percent. The program anticipated a small overall balance of payments surplus by 1986, to be achieved by a reduction in the current account deficit (after debt relief, excluding official transfers) from 8.7 percent of GDP in 1982 to 5.2 percent in 1987, by a significant improvement in net capital inflows, and by imposing tight restraint on nonconcessional borrowing. The Government's overall deficit (including grants) was to be reduced from 7.1 percent of GDP in 1982/83 to 4.8 percent by 1985/86. The expansion of domestic credit was to be restrained, allowing for the credit needs of the private sector while limiting the use of bank credit by the Government and public enterprises. The authorities undertook a number of measures to improve the operational efficiencies, tariff structures and investment portfolios of major parastatals. This was to be supported by the general liberalization of price control and further improvement of production incentives.

1. Output, expenditure and prices

Output grew more strongly than projected in both 1983 and 1984. In 1984 GDP grew by 4.1 percent, with the main impetus coming from the agricultural sector (Table 2). Manufacturing output stagnated, with a sharp rise in the output of the export sector being offset by a fall in domestic manufacturing. There were significant gains in the terms of trade, and real national income, adjusted for changes in the terms of trade, is estimated to have risen by 6.2 percent (or by 3.5 percent in per capita terms).

Gross fixed investment is provisionally estimated to have fallen to about 12 percent of GDP in 1984, compared with an average of about 15 percent in 1981-83. This partly reflected the contraction in the Government's

Table 2. Malawi: Gross Domestic Product and Expenditure, 1982-88

	1982	1983 <u>1/</u>	1984 <u>1/</u>	1985	1986	1987	1988
(In millions of Malawi kwacha at current market prices)							
Gross domestic product	1,208.2	1,419.1	1,700.9	2,022.3	2,248.7	2,513.0	2,748.9
Total consumption	1,105.6	1,343.2	1,492.9	1,802.9	2,013.6	2,219.7	2,395.7
Gross fixed investment	181.7	197.3	200.0	238.6	269.8	326.7	384.9
Net exports	-79.1	-121.4	8.0	-19.3	-34.7	-33.4	-31.6
Exports of goods and non-factor services	280.2	298.2	467.2	588.1	640.6	662.1	689.2
Imports of goods and non-factor services	359.3	419.6	459.2	607.3	675.3	695.5	720.8
Domestic saving <u>2/</u>	95.7	94.9	242.5	231.4	252.7	310.0	371.3
Net factor income from abroad	-31.5	-76.7	-90.8	-110.5	-124.0	-120.1	-114.2
National saving	64.2	18.2	151.7	120.9	128.7	189.9	257.1
Foreign saving	117.5	179.1	48.3	117.7	141.1	136.8	127.8
Transfers from abroad (net)	38.3	49.6	49.1	70.0	85.4	94.6	107.4
Foreign capital flows (net)	32.5	75.2	90.3	24.0	133.3	32.6	38.4
Change in foreign reserves	46.7	54.3	-91.1	23.7	-77.6	9.6	-18.0
Total saving	181.7	197.3	200.0	238.6	269.8	326.7	384.9
(Percentages)							
Memorandum items:							
As a percentage of GDP							
Total consumption	91.5	94.7	87.8	89.2	89.5	88.3	87.2
Gross fixed investment	15.0	13.9	11.8	11.8	12.0	13.0	14.0
Net exports	-6.5	-8.6	0.5	-1.0	-1.5	-1.3	-1.2
Exports of goods and non-factor services	23.2	21.0	27.5	29.1	28.5	26.3	25.1
Imports of goods and non-factor services	29.7	29.6	27.0	30.0	30.0	27.7	26.2
Domestic saving	7.9	6.7	14.3	11.4	11.2	12.3	13.5
National saving	5.3	1.3	8.9	6.0	5.7	7.6	9.4
Rates of change							
GDP at constant factor cost	2.8	3.5	4.1	2.7	1.0	2.0	3.0
GDP at current market prices	12.9	17.5	19.9	18.9	11.2	11.8	9.4
GDP deflator (market prices)	10.3	14.3	13.8	13.9	10.1	9.6	6.2

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

1/ The official national accounts data for 1983 and 1984 are incomplete, and the figures shown for these years are based in part on staff estimates. Data for 1985 et seq. are staff estimates.

2/ Excluding financing of stock accumulation.

Table 8. Malawi: Balance of Payments, 1983-88

(In millions of SDRs)

	1983	1984	1985	1986	1987	1988
Current account 1/	-141.6	-45.5	-62.5	-60.6	-64.5	-55.0
Trade balance	-74.2	25.5	8.3	11.8	2.1	4.5
Exports, f.o.b.	215.5	301.6	305.7	319.6	329.2	341.8
Imports, c.i.f.	-289.7	-276.1	-297.4	-307.8	-327.1	-337.3
F.o.b. value	-185.4	-165.7	-184.4	-193.9	-209.3	-218.9
C.i.f. margin	-104.3	-110.4	-113.0	-113.9	-117.8	-118.4
Service and transfers	-67.4	-71.0	-70.8	-72.4	-66.6	-59.5
Nonfactor services	-22.5	-20.0	-19.0	-18.7	-18.0	-17.0
Receipts	21.9	20.8	23.0	25.0	27.0	29.0
Payments	-44.4	-40.8	-42.0	-43.7	-45.0	-46.0
Factor services	-56.8	-59.1	-61.8	-66.7	-64.6	-61.5
Receipts	1.2	1.9	2.5	3.7	5.0	6.5
Payments	-58.0	-61.0	-64.3	-70.4	-69.6	-68.0
Interest	-40.6	-45.4	-45.3	-49.4	-48.6	-46.0
Other	-17.4	-15.6	-19.0	-21.0	-21.0	-22.0
Private transfers	11.9	8.1	10.0	13.0	16.0	19.0
Receipts	22.5	20.4	23.0	26.0	29.0	32.0
Payments	-10.6	-12.3	-13.0	-13.0	-13.0	-13.0
Capital account	98.5	108.4	47.5	109.7	58.4	66.4
Long-term (net)	87.5	88.1	42.5	104.7	52.4	59.4
Government transfers	27.6	25.8	29.1	33.0	34.9	38.8
Credit	28.6	27.7	31.0	35.0	37.0	41.0
Debit	-1.0	-1.9	-1.9	-2.0	-2.1	-2.2
Government loans	50.3	63.0	19.8	73.0	16.4	14.5
Credit (other)	60.7	38.6	52.0	50.0	55.0	55.0
SAL II and III	--	51.9	--	65.0	--	--
Debit	-10.4	-27.5	-32.2	-42.0	-38.6	-40.5
Public enterprises	-4.0	-4.1	-9.3	-5.8	-3.4	1.2
Credit	0.7	0.7	2.0	4.0	6.0	8.0
Debit	-4.7	-4.8	-11.3	-9.8	-9.4	-6.8
Private enterprises	13.6	3.4	2.9	4.5	4.5	4.9
Credit	18.9	9.6	9.5	10.5	10.5	11.0
Debit	-5.3	-6.2	-6.6	-6.0	-6.0	-6.1
Short-term flows and unidentified	11.0	20.3	5.0	5.0	6.0	7.0
Overall balance after debt relief	-43.1	62.9	-15.0	49.1	-6.1	11.4
Financing						
Balance	43.1	-62.9	15.0	-49.1	6.1	-11.4
Use of Fund resources	23.9	17.5	8.2	3.0	-24.3	-21.7
Change in reserves	19.2	-80.4	6.8	-52.1	30.4	10.3
Memorandum items:						
Debt relief	50.0	22.9	-13.7	-21.7	-27.1	-28.4
Of which: interest	4.1	2.2	-9.0	-8.2	-6.9	-5.3
Current account/GDP ratios 1/						
After debt relief	-12.5	-3.9	-5.5	-5.0	-4.8	-3.7
Before debt relief	-12.9	-4.1	-4.7	-4.3	-4.3	-3.4
Growth rates of trade volumes (percent per annum)						
Exports	7.1	20.3	9.3	5.5	1.3	1.4
Imports	-8.7	-14.9	6.0	0.1	2.8	-0.4
Change in terms of trade (percent per annum)	-20.5	4.1	-8.7	-7.4	1.8	-1.3
Gross official reserves (in months of c.i.f. imports)	12.8	57.0	50.2	102.3	71.9	61.6
	(0.5)	(2.5)	(2.0)	(4.0)	(2.6)	(2.2)

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

1/ With grants below the line.

are projected at a level equivalent to three months of imports, c.i.f. during this period. Given the projected net inflows of capital, the revised current account target will provide for an accumulation of reserves sufficient to allow Malawi to continue meet its external obligations, including repurchases from the Fund, by 1986, after the end of the arrangement.

In the current account, the value of exports in SDR terms is projected to increase at an annual average rate of 3 percent during 1985-88. Although export volumes are projected to increase at an average annual rate of 4 percent, export prices, particularly for tobacco and tea, are projected to decline. ^{1/} The increases in export volumes are expected as a result of higher production owing to the increases in agricultural producer prices. In addition, some improvement in the transport situation is expected to allow some stocks--notably of sugar--to be exported. Moreover, favorable producer prices for crops such as cotton and groundnuts are expected to contribute to a gradual diversification in exports from the dependence on tobacco and tea. The easing of transport difficulties is expected to result in a decline in the c.i.f. margin from 40 percent in 1984 to 35 percent by 1988. Nevertheless, import prices (c.i.f.) are projected to rise at an annual average rate of 3 percent annually during 1985-88 reflecting increases in the prices for industrial countries' manufactured exports. Hence, the improvements in the terms of trade experienced in 1984 is expected to be reversed; prospects for the terms of trade show a deterioration at an annual average rate of 4 percent annually during 1985-88. The balance on the services account is projected to remain broadly unchanged during 1985-88. Given the projections for these elements of the current account, the forecast for capital flows, and the target for reserves, the sustainable rate of growth in import volume is estimated to be about 2 percent annually during 1985-88.

The two rescheduling arrangements in 1982 and 1983 have alleviated the bunching of debt service payments during 1982-84. However, as repayments on rescheduled debt begin in 1985, the debt service ratio, including Fund repurchases and charges as well as the debt service associated with new borrowing after 1984, is projected to increase to a peak of 37 percent of exports of goods and nonfactor services in 1986 before declining to 33 percent in 1988 (Table 7 and Chart 6). While this ratio is below that reached in 1982-84 (40-50 percent) when Malawi had to undertake debt rescheduling, it is still high by historical standards. Therefore, there continues to be a need to implement policies to contain the current account deficit to about 4-5 percent of GDP after 1986 in order that Malawi can manage its debt service commitments adequately and to maintain reserves at about 2.5 months of imports.

^{1/} In February and March 1984 tea prices in London fell sharply. Trading in the early part of the year is generally very light and the market volatile. It appears premature to make substantial revisions, but, unless prices recover, the projections may require downward revision.

1985 Consultation

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Malawi in the light of the 1985 Article IV consultation with Malawi conducted under Decision No. 5392-(77/63) adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").
2. Malawi continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV, Section 2, as described in SM/85/121. The Fund notes that Malawi's exchange system is administered in a flexible manner.

Review Under Extended Arrangement

1. Malawi has consulted with the Fund in accordance with paragraph 4(c) of the extended arrangement for Malawi and paragraph 31 of the memorandum attached to the letter from the Minister of Finance and the Governor of the Reserve Bank of Malawi dated June 25, 1984, attached to the extended arrangement for Malawi (EBS/83/183, Supplement 1, and EBS/84/151), in order to reach understandings with the Fund regarding policies and measures that Malawi will pursue through March 31, 1986.
2. The letter dated April 12, 1985 from the Minister of Finance and the Governor of the Reserve Bank of Malawi, together with an accompanying Economic Policy Memorandum, shall be attached to the extended arrangement for Malawi, and the letter dated July 29, 1983, together with the accompanying Economic Policy Memorandum, shall be read as supplemented by the letter dated April 12, 1985 together with the accompanying Economic Policy Memorandum.
3. Malawi will not make purchases under the extended arrangement that would increase the Fund's holdings of Malawi's currency in the credit

tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota

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

- (i) the ceiling on the net domestic assets of the banking system as specified in paragraphs 24 and 25 of the Memorandum attached to the letter dated April 12, 1985, or
- (ii) the ceiling on the net credit to the Government of the banking system as specified in paragraphs 24 and 25 of the Memorandum attached to the letter dated April 12, 1985, or
- (iii) the limit on external borrowing as specified in paragraph 10 of the Memorandum attached to the letter dated April 12, 1985,

has not been observed; or

(b) during any period after December 31, 1985, until the review with the Fund contemplated in paragraph 33 of the Memorandum attached to the letter dated April 12, 1985 has been completed, or, following that review, while any performance criteria established by the Fund pursuant to the review are not observed.

4. The extended arrangement shall be amended as follows:

- (a) In paragraph 1, replace "SDR 100 million" with "SDR 81 million."
- (b) In paragraph 2(b), replace "April 30, 1985" with "May 31, 1985," and "SDR 47 million" with "SDR 34 million."

(c) In paragraph 2(c), replace "April 30, 1986" with "May 15, 1986," and "SDR 83 million" with "SDR 65 million."

(d) In paragraph 2(d), replace "April 30, 1985" with "May 31, 1985," and "April 30, 1986" with "May 15, 1986."

(e) In paragraph 4(c), replace "April 29, 1985" with "May 30, 1985," and "April 29, 1986" with "May 14, 1986."

(f) At the end of paragraph 4 add the following as paragraph 4(e):
"Malawi will not make purchases under this extended arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action with respect to a non-complying purchase."

5. Until May 15, 1986, purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 65 million provided that purchases shall not exceed the equivalent of SDR 41 million until August 15, 1985, the equivalent of SDR 49 million until November 15, 1985, and the equivalent of SDR 57 million until February 15, 1986.

Malawi: Selected Economic and Financial Indicators, 1981-87

	1981	1982	1983		1984		1985	1986	1987
			Orig. EFF	Act.	Orig. EFF	Rev. prog.	Est.	Projections	1/
(Annual percent changes, unless otherwise specified)									
National income									
GDP at constant factor cost	-5.2	2.8	2.7	3.5	3.0	3.2	4.1	2.7	1.0
GDP deflator	11.2	10.3	9.7	13.1	9.7	10.1	15.0	13.9	10.1
Consumer prices	11.8	9.2	13.0	13.8	10.0	13.0	13.1	15.0	8.0
External sector									
Exports, f.o.b. (millions of SDRs)	244.3	220.0	220.5	215.5	248.1	232.1	301.6	305.7	319.6
Imports, c.i.f. (millions of SDRs)	297.3	276.4	288.8	289.7	300.0	308.7	276.1	297.4	307.8
Non-oil imports, c.i.f. (millions of SDRs)	250.9	233.4	238.8	242.3	...	269.4	...	...	...
Export volume	-19.8	-8.7	12.6	7.1	8.9	19.5	20.3	9.3	5.5
Import volume	-24.9	-4.5	0.6	-8.7	6.4	-1.0	-14.9	6.0	0.1
Terms of trade (deterioration -)	19.0	1.3	-13.7	-20.5	1.7	-4.4	4.1	-8.7	-7.4
Nominal effective exchange rate, year-end (depreciation -)	9.3	-8.2	...	-6.5	...	...	5.1	...	...
Real effective exchange rate, year-end (depreciation -)	6.1	-4.0	--	0.1	--	--	9.0	--	--
Government budget 2/									
Revenue	10.9	10.6	13.2	17.1	14.9	17.5	21.8	30.7	8.7 3/
Total expenditure	9.5	-2.2	6.1	14.5	10.1	7.9	12.3	20.1	6.6 3/
Money and credit 2/									
Net domestic assets (increase) 4/	46.0	20.7	23.3	13.1	20.8 5/	17.8 5/	20.9	1.9	2.3
Credit to Government (increase) 4/	42.2	6.8	8.8	3.0	8.1 5/	4.9 5/	27.2 6/	-2.7	-6.6
Money and quasi-money (M2) (increase) 4/	15.0	12.7	12.8	10.6	14.7 5/	9.4 5/	28.1	8.9	11.3
Velocity (GDP relative to M2)	5.1	5.1	5.5	5.4	5.0 5/	5.5 5/	5.4	5.4	5.4
Interest rate (annual rate, 12-month time deposits)	10.75	10.75	12.75	12.75	...	...	12.75	14.25	...
(In percent of GDP) 7/									
Central Government									
Overall deficit 2/									
Excluding official transfers	15.6	12.4	9.0	10.4	8.0	7.7 8/	8.2 8/	6.7	6.0
Including official transfers	11.8	9.3	6.4	8.1	5.4	5.4 8/	6.0 8/	4.1	3.2
Domestic bank financing 2/	7.8	1.6	1.4	0.4	1.1	0.9	1.4	-0.5	-1.3
Foreign financing 2/ 9/	2.8	5.0	4.6	5.7	3.8	3.5	3.0	3.5	3.2
Gross fixed capital formation	15.7	15.0	15.4	13.9	16.6	16.3	11.8	11.8	12.0
Gross domestic saving 10/	7.2	7.9	9.7	6.7	11.7	10.1	14.3	11.4	11.2
Current account deficit									
Excluding official transfers	11.1	10.5	8.0	12.5	7.0	8.8	3.9	5.5	5.0
Including official transfers	7.3	7.3	5.5	10.1	4.3	6.3	1.7	3.0	2.3
External debt (inclusive of use of Fund credit) (in millions of SDRs) 11/	661.2	713.3	775.7	783.2	844.2	825.0	880.7	879.9	950.0
Debt service ratio 12/									
Before rescheduling	39.2	43.1	42.7	54.0	39.5	44.1	42.3	29.4	31.2
After rescheduling	34.2	36.4	22.0	32.9	30.5	33.4	35.2	33.5	37.2
Interest payments 9/ 12/	18.8	15.2	13.4	17.1	13.5	13.4	14.1	13.8	14.3
(In millions of SDRs, unless otherwise specified)									
Overall balance of payments									
Before rescheduling	-33.1	-57.0	-67.9	-93.1	-35.4	-38.7	40.0	-1.3	70.8
After rescheduling	-33.1	-40.2	-14.7	-43.1	-9.6	-10.4	62.9	-15.0	49.1
Gross official reserves (months of imports, c.i.f.)	1.6	0.9	1.2	0.5	...	...	2.5	2.0	4.0
External payments arrears	--	--	--	--	--	--	--	--	--

Sources: Data supplied by Malawian authorities; and staff estimates.

1/ Based on projections prepared for the 1985/86 program year.

2/ Fiscal year beginning April 1 of the year indicated.

3/ Constrained forecast assuming no additional revenue measures.

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

5/ Based on projections for calendar years.

6/ Includes special issue of Local Registered Stock for the Government's assumption of Press debt; excluding this, the change is 8.6 percent of broad money.

7/ Revisions to data from 1979 onward have resulted in a substantial downward revision to GDP. The targets of the original EFF have been left unaltered, and are thus not strictly comparable with the actual data.

8/ Excluding the special issue of Local Registered Stock for the Government's assumption of Press debt.

9/ After debt relief.

10/ Excluding the financing of stock building.

11/ End of period, public and publicly guaranteed medium- and long-term debt.

12/ In percent of exports of goods and nonfactor services. Based on data provided by the TBRD and including IMF charges, repurchases, and estimated debt service on private debt.