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AGENDA**

EBS/83/27
Correction 1

CONFIDENTIAL

February 7, 1983

To: Members of the Executive Board

From: The Secretary

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

The attached pages 13 through 16, which were incorrectly assembled in EBS/83/27 (2/3/83), are now printed in the proper order.

Att: (1)

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

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

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

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

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

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

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

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

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

(In millions of U.S. dollars)

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

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

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

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

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

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

3. Economic prospects

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

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

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

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

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

4. Statutory bodies and private sector enterprises

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

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

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

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