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FOR
AGENDA

EBS/88/25
Correction 1

CONFIDENTIAL

February 19, 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

The following corrections have been made in EBS/88/25 (2/9/88):

Page 1, para. 1, line 7: for "Chimango, of the Reserve Bank of Malawi;"
read "Chimango, Minister of Finance;
Mr. S. Chimwemwe Hara, Governor of the
Reserve Bank of Malawi;"

Page 2, Table 1, last column, penultimate line:

for: "-0.66	-0.64	-0.56	-0.64	-0.20	-0.64"	
read:	-0.66	-0.64	-0.56	-0.64	-0.20	-0.64"

Page 12, Table 5, column 3, line 1: for "333.1" read "-333.1"

Page 32, draft decision, para. No. 2, line 3:

for "evidenced by arrears on commercial payments are"
read "evidenced by external payments arrears are"

<u>Page 48, under Subsection II, stub c. Fund credit:</u>	for "80.81	217.20"
	read "77.74	208.99"

Corrected pages are attached.

Att: (5)

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, Minister of Finance; Mr. S.Chimwemwe Hara, Governor 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				1989	
		Jan.- March	April- June	July- Sept.	Oct.- Dec.	Jan.- March	April- June
(In millions of SDRs)							
Net use of Fund credit <u>1/</u>		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
(In millions of SDRs)							
<u>Memorandum item:</u>							
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.

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 Dec.	1986		1987			1988			1989	
		March	Dec.	March	June	Sept.	March	June	Sept.	March	March Prog.
Foreign assets (net) 1/	-223.4	-304.7	-333.1	-341.1	-410.4	-254.8	-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	632.5	692.7	715.2	648.8	644.7
Domestic credit	618.4	673.6	753.4	692.2	798.7	769.5	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	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	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	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	-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)	(-192.5)
Other items (net) 1/	-59.6	-55.4	-112.2	-125.2	-203.7	-214.6	-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
SDR allocation	15.4	19.6	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	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 separately 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.

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 external payments arrears 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.

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		
	<u>Millions</u>	<u>Percent</u>	
	<u>of SDRs</u>	<u>of quota</u>	
b. Total Fund holdings of Malawi kwacha	112.74	303.08	
c. Fund credit	77.74	208.99	
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

	<u>Date of arrangement</u>	<u>Duration (months)</u>	<u>Total amount</u>	<u>Utilization</u>
a. Previous arrangements				
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).