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**Statement by Mr. Sukada and Mr. Win on Malawi
(Preliminary)
Executive Board Meeting 06/77
August 30, 2006**

We thank staff for the well-written set of papers and Messrs. Gakunu and Masawe for their helpful Buff statement. We are pleased to note that, under the current PRGF arrangement, the Malawian authorities have made satisfactory progress in strengthening macroeconomic performance despite a severe food crisis and an intense political environment.

Performance relative to the program targets was broadly satisfactory as all the quantitative performance criteria and all the indicative targets for end-December 2005 were met, with the exception of an indicative target on discretionary government spending being missed on account of additional spending related to the food security outlays. In light of Malawi's satisfactory track record and the authorities' continued commitment to successful program implementation, we support the authorities' request for the waivers and the completion of the Second Review under the PRGF arrangement.

Notwithstanding the satisfactory progress of program implementation, Malawi still faces the daunting challenges in achieving the MDGs. The incidence of poverty and HIV/AIDS pandemic still remain, and external debt is unsustainable while the vulnerabilities to the effects of crop shortfalls and higher world oil prices could put the implementation of the program at risk. Malawi's debt sustainability remains vulnerable to exogenous shocks. Medium-term prospects, therefore, would depend critically on the pursuit of sound macroeconomic policy, an accelerated pace of structural reform, and external assistance in the form of grants.

As for the reasons outlined in para 20 of the staff report, we agree with staff that Malawi has met the condition for reaching the enhanced HIPC completion point, and is subsequently eligible for debt relief under the MDRI. We support the authorities' request for waivers for the non-observance of the two completion point triggers relating to the share of health sector expenditures and teacher's training as the authorities have made efforts towards achieving them. Malawi's external debt analysis shows a substantial deterioration in debt burden indicators compared to the projections made at the decision point which was primarily due to exogenous factors, such as a lower discount rate and lower-than-projected export receipts resulting in the unanticipated increase in the NPV of debt-to-export ratio at end-2005. On this

ground, we also support the staff's recommendation that Malawi be granted for additional and exceptional assistance under the HIPC initiative to lower Malawi's NPV of debt-to-exports ratio at end-2005 to 150 percent.

Malawi's external debt burden indicators would fall to levels significantly lower than the average of LICs after the country is granted the debt relief under the HIPC, MDRI, and topping-up of HIPC assistance. Nonetheless, staff rightly emphasizes that Malawi needs to actively pursue policies that encourage export diversification and prudent fiscal and debt management policies in order to maintain debt sustainability over the medium and long-term. Higher borrowing and weaker export growth could lead to a sharp increase in Malawi's NPV of debt-to-export ratio to 196 percent by 2025, as illustrated in Scenario 2 of the debt sensitivity analysis (EBS/06/110). We also urge Malawi to continue seeking debt relief from its non-Paris Club creditors within the framework of the HIPC initiative.

On fiscal front, we note that the fiscal performance weakened in the second half of 2005/06 due to scaled-up food security operations and some expenditure slippages while the overall fiscal performance in 2005/06 was satisfactory. Increased spending on food security is understandable in light of the need to ward off a humanitarian crisis. We agree with staff that reducing the domestic debt burden will remain the cornerstone of the fiscal strategy. We welcome the authorities' commitment in containing the wage bill overrun which resulted in keeping the estimated annual wage bill within the program limits. We are reassured by Messrs. Gakunu and Masawe that the authorities continue implementing measures aimed at improving public financial management and governance.

On monetary and exchange rate policies, we welcome the authorities' commitment to maintain price stability in a backdrop of higher world oil prices. We note that reducing the LRR has helped reduce the wide spread between commercial bank's deposit and lending rate and facilitated a more market based monetary policy instrument. The authorities appropriately tightened the reserve money target by mopping up the excess liquidity following the reduction in the LRR so as to contain inflationary risks. It is understandable that interventions in the foreign exchange market by the Reserve Bank of Malawi is unavoidable to smooth exchange rate volatility considering the thin market.

On structural reform, we welcome the authorities' medium-term agenda for structural reforms that is being developed in the context of the Malawi Growth and Development Strategy (MGDS) and expected to be resubmitted to the parliament in the coming months. The authorities' action plan to improve the Public Financial Management (PFM) would strengthen public expenditure management and help in monitoring that the resources freed up by debt relief are used effectively. In this vein, phasing in of the new IFMIS and centralized payment system is a step in the right direction. While the authorities' commitment in taking further steps to ensure the viability of the pension system is encouraging, reforming the pension system over the medium-term is vital to keep the pension costs at a sustainable level.

With these remarks, we wish the authorities every success in their future endeavors.