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**IMF Executive Board Approves US\$77.1 Million Exogenous Shocks Facility
Arrangement for Malawi**

The Executive Board of the International Monetary Fund (IMF) has approved a one-year, SDR 52.05 million (about US\$77.1 million) arrangement under the Exogenous Shocks Facility (ESF) for Malawi, to support the authorities in their adjustment to the terms of trade shock caused by rapid increases in fuel and fertilizer prices in the first part of 2008. The decision will enable Malawi to draw an amount equivalent to SDR 34.7 million (about US\$51.4 million) from the IMF immediately.

This is the first ESF-supported program to be approved by the IMF's Executive Board. In September 2008, the Executive Board approved modifications to the ESF which provided for faster and higher access, made the facility easier to use, and enhanced its flexibility. These modifications took effect in late November following the receipt of all the necessary legal consents.

Following the Executive Board's discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

“Malawi’s economic performance has been strong in recent years. Economic growth has been robust, inflation has been moderate, and debt sustainability has substantially improved.

“High world oil and fertilizer prices earlier in the year are putting pressure on inflation and foreign exchange reserves. Recent declines in the price of fuel and fertilizer should help over the medium term, but the negative effects of the earlier price hikes will persist over the next few months, because current imports of oil and fertilizers were contracted at earlier high prices. In this light, Malawi’s current low level of international reserves is a concern for financial stability and food security.

“The economic program to be supported by high-level access to IMF resources under the Exogenous Shocks Facility will help to contain the pressure on the balance of payments and

rebuild external reserves. Financing will be complemented by fiscal and monetary tightening. Additional donor support has been forthcoming, and will be critical to facilitate the economy's adjustment to the terms of trade shock.

“The government's planned reduction in domestic borrowing in 2008/09 is a key element of the fiscal adjustment. To this end, it will be important to enhance fiscal discipline, including through further improvements in public financial management. Spending pressures will need to be resisted, particularly in the run-up to the May 2009 general elections, in order to safeguard foreign exchange reserves and priority investments,” Mr. Kato said.

Recent Economic Developments

Over the last three years, Malawi's economy has experienced high real GDP growth and moderate, but recently rising, inflation. Consumer prices increased by 9.3 percent in the 12 months to September 2008, largely because of a 25 percent increase in fuel prices in June 2008. Food price inflation continues to be subdued, although domestic maize prices reportedly increased sharply in some areas in the first half of 2008.

Malawi's terms of trade deteriorated significantly in 2008, despite solid increase in tobacco export prices and the recent easing of world oil prices. Significantly higher world prices of oil, fertilizers, and other imported goods for most of 2008 adversely affected Malawi's trade balance. In 2008 the net impact on the trade balance from this worsening of Malawi's terms of trade could amount to US\$156 million. Recent declines in the price of fuel and fertilizer should help over the medium term, but the negative effects of the earlier price hikes will persist over the next few months, because current imports of oil and fertilizers were contracted at earlier high prices. Although international reserves have been temporarily buttressed by the seasonal concentration of tobacco proceeds in April-September, gross reserves at the end of September 2008 were only US\$175 million, corresponding to 1.1 months of imports.

A tight budget for the fiscal year 2008/09 has been approved despite significant political hurdles. Targeted domestic debt repayment in 2008/09 is 0.1 percent of GDP, compared with borrowing of 1.3 percent of GDP in 2007/08.

Monetary policy has brought short-term interest rates up to levels more consistent with medium-term inflation objectives and the reserve situation.

The government continues to place substantial weight on stabilizing the nominal exchange rate against the U.S. dollar, which has held steady since May 2006.

Program Summary

The government's program is designed to support continuing financial and macroeconomic stability, growth, and poverty reduction. During the ESF arrangement the main focus will be on adjusting to the terms-of-trade shock and rebuilding Malawi's reserve buffer while preserving medium-term momentum on growth and poverty reduction. The government aims to achieve these goals through a combination of restrained domestic demand and increased external support. At the same time, it is preparing a medium-term program to reform the money and foreign exchange markets and modernize the monetary policy framework.

Improving public financial management is crucial for ensuring financial stability, rebuilding international reserves, and achieving the goals set out in the Malawi Growth and Development Strategy (MGDS).

Malawi: Selected Economic Indicators 2006/07–20010/11

	2006/07 Act.	2007/08 Prel.	2008/09 Proj.	2009/10 Proj.	2010/11 Proj.
National accounts and prices					
GDP at constant market prices	7.7	8.7	7.6	6.9	6.1
Nominal GDP (MK billions)	466.1	547.3	638.0	731.7	826.5
Nominal GDP per capita (US\$)	252.8	288.5	329.0	363.8	385.4
GDP deflator	14.6	8.0	8.3	7.3	6.5
Consumer prices end of period)	7.6	8.5	8.5	6.6	6.4
Food	6.8	6.5	7.3	6.0	6.2
Nonfood	8.6	10.7	9.7	7.1	6.7
Consumer prices (annual average)	10.0	7.7	8.4	7.0	6.6
Investment and savings (percent of GDP)					
National savings	21.7	21.5	18.6	19.8	18.0
Government	10.3	8.9	5.0	8.3	7.3
Private	11.4	12.6	13.6	11.5	10.7
Gross investment	24.4	26.9	24.5	24.6	23.3
Government	11.5	11.7	8.7	10.8	9.7
Private	12.9	15.2	15.9	13.8	13.5
Saving-investment balance	-2.7	-5.3	-6.0	-4.8	-5.3
Government	-1.2	-2.7	-3.7	-2.5	-2.5
Private	-1.5	-2.6	-2.3	-2.3	-2.8
Central government (percent of GDP)					
Revenue (excluding grants)	18.1	19.2	19.4	19.5	20.0
Grants	13.6	10.9	13.2	12.2	12.7
Expenditure and net lending	33.0	32.8	36.2	34.2	35.1
Overall balance (excluding grants)	-14.9	-13.6	-16.9	-14.7	-15.2
Overall balance	-1.3	-2.7	-3.7	-2.5	-2.5
Foreign financing	0.8	1.4	3.8	3.5	3.6
Domestic financing	0.5	1.3	-0.1	-1.0	-1.1
Money and credit (contribution to M2 growth)					
Money and quasi money	24.7	41.3	9.5	13.7	13.4
Net foreign assets	19.7	-2.6	-4.1	11.0	12.9
Net domestic assets	5.0	43.9	13.6	2.7	0.6
Credit to the government	-9.8	51.2	0.9	0.5	-5.2
Credit to the rest of the economy	18.9	22.3	13.1	9.0	10.8
Velocity	5.1	4.3	4.6	4.7	4.6
Money and credit (percent change)					
Money and quasi money	24.7	41.3	9.5	13.7	13.4
Net foreign assets	91.4	-7.8	-18.9	68.9	54.2
Net domestic assets	6.3	65.7	17.3	3.2	0.8
Credit to the government	-29.2	101.5	3.2	1.8	-22.7
Credit to the rest of the economy	46.8	46.8	26.5	15.8	18.6
External sector (millions of US\$)					
Exports, f.o.b.	610.0	829.4	1,030.6	1,104.2	1,175.4
Imports, c.i.f.	-1,140.7	-1,274.4	-1,447.5	-1,536.8	-1,673.1
Usable gross official reserves	181.3	202.6	256.5	371.2	505.0
(months of imports)	1.2	1.3	1.5	2.0	2.6
Current account	-2.7	-5.3	-6.0	-4.8	-5.3
Current account (excluding official transfers)	-16.4	-17.2	-17.5	-17.1	-17.0
Nominal effective exchange rate	-2.6	-1.4
Real effective exchange rate	0.8	-1.2
Domestic debt (percent of GDP)					
Net domestic debt (central government)	12.2	17.1	14.6	11.7	9.3
Of which: excluding recapitalization of RBM	12.2	11.7	9.9	7.7	5.7
Net consolidated domestic debt (central bank and central government)	14.6	11.6	7.8	6.4	5.9
Domestic interest payment	3.1	2.1	2.6	2.1	1.6
Treasury bill rate (period average)	20.9	10.1

Sources: Malawian authorities; and IMF staff estimates and projections.