International Monetary Fund

IMF Mission and Malawi Authorities Reach Staff-Level Understandings on a New ECF-Supported Program

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A team from the International Monetary Fund (IMF) visited Lilongwe during May 23-June 6, 2012 for discussions with Malawi's new government, in the context of the 2012 Article IV consultation and the authorities' intention to request a new three year arrangement under the IMF's Extended Credit Facility (ECF)[1]. The mission was received by Her Excellency President Joyce Banda, and held discussions with Minister Ken Lipenga (Finance), Governor Charles Chuka (Reserve Bank of Malawi), Deputy Minister Khwauli Msiska (Economic Planning and Development), Secretary to the Treasury Randson Mwadiwa, and other senior government and RBM officials, members of the Budget and Finance Committee of the National Assembly, as well as with representatives of Malawi's international development partners, civil society, and the banking and business communities. The mission is grateful to the authorities for the constructive spirit in which discussions were held and for their warm hospitality.

At the conclusion of the mission, Mr. Tsidi Tsikata, mission chief for Malawi, issued the following statement:

"We congratulate President Banda on her assumption of the office of Head of State and applaud the smooth transition to the new administration following the unexpected death of President Bingu wa Mutharika in early April 2012. We extend our condolences to the Mutharika family and the nation at large.

"The mission has reached staff-level understandings with the authorities on an economic program for the fiscal years 2012/13–2014/15 that could be supported by a new ECF arrangement in the amount of SDR104 million (about US$157 million). The new arrangement is subject to approval by the IMF's Executive Board which is expected to consider the authorities' request in July 2012. The new arrangement will replace the three-year arrangement approved in February 2010 which the authorities have requested be cancelled in order to start on a clean slate.

"During our last visit to Malawi two months ago, the country was facing a severe foreign exchange shortage that was slowing down economic activity, as several enterprises scaled down their operations for lack of imported inputs, and fuel shortages disrupted transportation services and energy supplies, with ripple effects across all sectors. A growing stock of payments arrears had led to loss of external credit lines and a negative outlook for a speedy recovery. While the foreign exchange situation was triggered by a fall in the country's tobacco earnings and aid inflows in 2011, the authorities' response to these shocks—a small devaluation accompanied by a tightening of restrictions on foreign exchange transactions—created distortions which fostered a parallel foreign exchange market and boosted informal activity at the expense of the formal economy, with adverse consequences for government revenues. Moreover, the official exchange rate failed to anchor inflation expectations as a growing share of imports was being priced at the significantly depreciated parallel market exchange rate.

"The new government has moved swiftly and boldly to change the policy environment and begin to address Malawi's chronic imbalance between foreign exchange earnings on the one hand, and the demand for foreign exchange on the other. A devaluation that increased the price of foreign exchange by nearly 50 percent, the adoption of a floating exchange rate regime, and the lifting of several restrictions on foreign exchange transactions have virtually eliminated the parallel market. Judicious intervention in the foreign exchange market by the Reserve Bank of Malawi (RBM) has helped clear some of the backlog of external payments while tightening liquidity conditions in the domestic market. The mission found overwhelming support in the private sector for the policy changes: exporters welcomed the boost to their incomes in local currency terms, importers were optimistic about the prospects for increased availability of foreign exchange to support a recovery in economic activity, and banks reported increased purchases of foreign exchange from customers. All stressed the importance on improving the investment climate in order to strengthen Malawi's international competitiveness relative to countries in the sub-region. The policy changes have also been welcomed by Malawi's development partners who have pledged to substantially increase their support to the FY2012/13 budget.

"The mission discussed the critical role of appropriate fiscal and monetary policies for avoiding an inflation spiral and realizing the expected benefits from the recent policy actions. To that end, the objectives of the program to be supported by the new ECF arrangement include fiscal sustainability and a gradual build up of international reserves to help cushion the economy against external shocks. More broadly, the program will guide the implementation of policies to create the stable macroeconomic environment needed to achieve the main objective of the second Malawi Growth and Development Strategy (MGDS II) of reducing poverty through sustained private sector led growth and wealth creation.

"The FY2012/13 budget will be an important vehicle for implementing the ECF-supported program. The government is giving high priority to ensuring adequate provisions for scaling up social protection programs in the budget to mitigate the impact of the devaluation on the welfare of the most vulnerable segments of the population. Fiscal discipline will be required to keep overall government spending within the available resource envelope while protecting the government's top priorities and avoiding the recent history of excessive domestic borrowing and the accumulation of huge domestic arrears. Monetary policy will be geared toward achieving price stability, while providing room for growth in credit to the private sector. The authorities have agreed on limits to the government's total borrowing from the RBM and on steps to enhance the operational independence of the RBM.

"The mission expressed concern over significant and growing risks to public finances from the operations of state-owned enterprises and the setting of prices and tariffs below cost recovery levels. In this regard, the mission welcomed the recent changes to the pricing and taxation of petroleum products and the adoption of an automatic adjustment mechanism to ensure that retail prices of these products reflect the true cost of importation. If the new rules are adhered to, fuel prices should move up and down in line with world prices. In order to contain fiscal risks from the operations of the National Oil Company of Malawi (NOCMA), the mission urged the authorities to limit its operations to its mandate of managing the country's strategic fuel reserves and to revert to reliance on the private sector for the importation of fuel to meet the country's regular consumption needs.

"The mission discussed the issue of data integrity following the recent revelation that the Ministry of Finance inflated revenue data reported to parliament in the context of the midyear review of the budget earlier this year. The mission recommended that henceforth the Malawi Revenue Authority report information on its monthly revenue collections directly to the public and not just to the Ministry of Finance. The authorities requested technical assistance from the IMF and other partners to improve the quality of a wide range of economic statistics."

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[1] The Extended Credit Facility (ECF) has replaced the Poverty Reduction and Growth Facility (PRGF) as the IMF's main tool for medium-term financial support to low-income countries. It provides for a higher level of access to financing, more concessional terms, enhanced flexibility in program design, and more focused, streamlined conditionality. Financing under ECF currently carries a zero interest rate, with a grace period of 5½ years, and a final maturity of 10 years.

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