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December 9, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Malawi - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Malawi which supersedes the paper issued as EBS/86/190 (8/18/86) and is referred to in EBD/86/315 (12/3/86). A draft decision appears on page 28.

It is proposed to bring this subject to the agenda for discussion on Monday, January 5, 1987.

Mr. Dicks-Mireaux (ext. 8651) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the 1986 Article IV Consultation

Prepared by the Staff Representatives for the
1986 Consultation with Malawi

Approved by A.D. Ouattara and W.A. Beveridge

December 8, 1986

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I. Introduction

A staff mission visited Malawi during May 27-June 18, 1986 to hold discussions on the 1986 Article IV consultation, and on the possible use of Fund resources under a stand-by arrangement and the structural adjustment facility (SAF). Discussions were held with the Minister of Finance, the Governor of the Reserve Bank of Malawi, and senior officials of the Treasury, the Reserve Bank, and other governmental and parastatal institutions concerned with economic and financial matters. Additional discussions were held in Malawi during September 10-13, in Washington during October 2-8, and again in Malawi during October 28-November 8. 1/

A three-year extended arrangement was approved by the Fund in September 1983 (EBS/83/183, 8/26/83) for an amount equivalent to SDR 100 million (268.8 percent of Malawi's quota of SDR 37.2 million). Owing to the long delay in completing the third review (EBS/85/101, 4/28/85), the amount available under the arrangement was reduced by SDR 19 million, to SDR 81 million (217.7 percent of quota). Discussions related to a fourth review under the arrangement were initiated in November 1985 and continued in January and February 1986. For reasons explained below, that review could not be completed, and, at the authorities' request, the arrangement was canceled on August 5, 1986. In all, Malawi purchased SDR 57 million under the arrangement, with the last purchase being effected on December 31, 1985.

Malawi continues to avail itself of the transitional arrangements under Article XIV. The last Article IV consultation discussions, together with discussions on the program for the third year under the extended arrangement, were held in Malawi during February 15-March 1, 1985. The consultation and review were concluded on May 22, 1985 (EBM/85/77, 5/22/85). Summaries of Malawi's relations with the Fund and the World Bank Group are provided in Appendices II and III, respectively. Appendix IV provides a summary of statistical issues.

II. Economic Performance Through 1985/86

1. Background

Malawi's economic and financial program for 1985/86 (April-March) under the extended arrangement was set against the background of strong

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1/ The staff representatives during the June mission included Mr. G.B. Taplin (head-AFR), Ms. H. Bierman (FAD), Ms. B. Vibe Christensen (ETR), Mr. M. Bell (AFR), Mr. H. Futamura (AFR), and Mrs. A. Groën (secretary-ADM). Mr. J.A.K. Munthali, Assistant to the Executive Director for Malawi, participated in the discussions. The September staff visit comprised Mr. A. Basu (head-AFR) and Ms. H. Bierman (FAD); the November staff visit included Mr. D. Donovan (head-AFR), Ms. H. Bierman (FAD), Mr. M. Bell (AFR), and Mr. L. Dicks-Mireaux (AFR).

external performance in 1984, but with a significant weakening in the external position in prospect. Executive Directors noted this in concluding the 1985 Article IV consultation, in May 1985, and stressed the need for appropriate domestic financial policies to ensure the sustainability of the balance of payments in the medium term. Directors welcomed the intended substantial strengthening of policies in 1985, including the adjustment of the exchange rate, the change in the structure of interest rates to positive rates in real terms, and the intention to eliminate price control by the end of the year. They also welcomed the authorities' intention of achieving a substantial reduction in the Central Government's deficit relative to GDP in 1985/86, as otherwise the program's medium-term objectives would be jeopardized, but expressed concern over the persistent difficulty of keeping government expenditure within programmed limits. They stressed that the targeted deficit reduction could be realized only if supported by a firmer monitoring and control over expenditure than had been achieved previously. In the view of many Directors, the heavy burden of external debt underscored the need to maintain external competitiveness.

In 1985 economic performance fell short of expectations, thereby unwinding some of the adjustment that had been achieved thus far under the extended arrangement. The external current account showed a deficit of 9.5 percent of GDP, 4.0 percentage points larger than the program target, and 8.1 percentage points above the deficit in 1984. This led to a significant decline in official reserves, which fell from 11 weeks of imports at the end of 1984 to 7 weeks at the end of 1985. There were further declines in 1986. In part this was due to a deterioration in Malawi's terms of trade and disappointing export performance, and in part it reflected a weakening in financial performance of the nonfinancial public sector, concentrated in the Central Government and in the Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops. For the Central Government, the overall deficit (including grants) of 8.2 percent of GDP in 1985/86 was double the program target, and approximately 2 percent of GDP higher than the outcome of the previous year. As a result of these factors, domestic credit expansion in 1985/86 was far in excess of the programmed level, and as broad money contracted between March 1985 and March 1986, there was a rapid decline in net international reserves. Nevertheless, economic growth continued at a relatively even pace, with a further expansion in the smallholder agricultural sector.

The program targets were not realized in 1985 and the size and structural nature of the existing imbalance were such that no credible set of measures could be implemented in the period remaining to achieve the objectives of the extended arrangement, and thus balance of payments viability could not be achieved in 1986. As a consequence, the final review under the arrangement could not be completed, and the arrangement was canceled at the request of the authorities on August 5, 1986.

2. Output, expenditure, and prices

Preliminary estimates indicate that real GDP grew by 2.9 percent in 1985, slightly lower than the estimated 3.3 percent in 1984. A decline in the real output of the estate agricultural sector was offset by better growth performance in distribution and construction. The expansion of the output of the smallholder sector slowed because of a decline in total and marketed maize production. Nevertheless, developments in the maize sector were offset by a large rise in the marketed output of groundnuts, pulses, and treenuts, and a more modest rise in the marketed production of rice and cotton.

A major factor influencing the change in the pattern of agricultural production has been the movement of relative producer prices. The producer price for maize was raised by 67 percent for the 1982 crop. Despite a substantial relative realignment of prices in 1983-85, shifting incentives away from maize production, a large surplus of marketed maize emerged. The gradual reduction of fertilizer subsidies also eroded the relative incentive for maize and tobacco production, where fertilizers are used intensively. Continuing these trends, maize and tobacco producer prices were frozen for the 1985/86 crop year, while other prices were increased by about 10 percent.

Preliminary estimates suggest a significant rise in gross fixed investment, to 14.3 percent of GDP in 1985 compared with 12.5 percent in 1984, mainly attributed to the private sector, as the temporary high profitability of the export sector in 1984 apparently resulted in significant new investment in early 1985. This was reflected in a substantial rise in imports of capital goods. However, the relatively strong investment performance in 1985 was accompanied by a reduction in domestic savings, from 15 percent of GDP in 1984 to 10 percent, as the profitability of the export sector decreased, and the financial position of the public sector weakened.

Consumer prices rose at an annual average rate of 15.0 percent during 1985, compared with 12.4 percent in each of the two preceding years, reflecting a brief surge early in the year when prices were rising by an annual rate of 18 percent. By December, inflation had fallen to 12.5 percent. A renewed acceleration occurred in early 1986, to 14.6 percent in April, partly owing to increases in the officially controlled wholesale price of maize and other food crops. Moreover, transportation prices were rising sharply. Also, the program of price liberalization, which was completed in December 1985, 1/ could have temporarily pushed prices upward.

1/ Only five commodity groups, petroleum, low-grade meat, fertilizer, sugar, and motor vehicle spare parts, remained under control, compared with over 60 groups in 1983.

3. External developments

The balance of payments deteriorated sharply in 1985. The current account deficit (excluding official transfers) increased sixfold, to SDR 101 million (9.5 percent of GDP) in 1985 (Table 1), compared with a program target of 5.5 percent of GDP. Concurrently, net capital inflows declined by about one half, primarily reflecting (i) the hiatus between the second and third structural adjustment loans (SAL II and SAL III) of the World Bank; (ii) expiration of external debt relief from Paris and London Club creditors negotiated in 1982 and 1983; and (iii) large outflows reflected under errors and omissions. Consequently, the overall balance swung from a surplus of SDR 63 million in 1984 to a deficit of SDR 60 million in 1985. Gross reserves of the monetary authorities fell to SDR 40 million at the end of 1985, corresponding to seven weeks of imports, despite some use by the Reserve Bank of its short-term credit lines with foreign banks. The external debt service ratio rose by almost 7 percentage points, to 39 percent of exports of goods and nonfactor services, and external debt reached 78 percent of GDP by the end of 1985.

The deterioration in the current account was concentrated in the trade balance. However, the deterioration should be viewed against the high level of exports realized in 1984, when external demand led to higher prices and a sharp reduction in stocks of tobacco and maize, which had accumulated during 1983 when external transport routes were disrupted. In 1985 the terms of trade declined by about 15 percent, partly reflecting a fall in export unit values of 19 percent in SDR terms. Exports fell by 1 percent in volume terms. One factor is that Malawi had difficulties finding external markets for maize because some neighboring countries also had excess supplies. Expansionary fiscal policies and relaxation of import controls gave rise to an increase in import volumes of 12 percent, three times the growth of real GDP and almost double the programmed increase. Large outflows occurred in short-term capital (including errors and omissions) possibly a precursor to the larger ouflows that were to occur in 1986, associated, *inter alia*, with delays and shortfalls in the remittance of export proceeds.

In April 1985 the kwacha was depreciated by 15 percent against the currency basket to which it is pegged to reverse a real effective appreciation of the currency which had taken place since the fourth quarter of 1983. Between April and December 1985, the kwacha appreciated by about 7 percent in real effective terms, in large part reflecting the sharp depreciation of the South African rand against most major currencies. 1/

1/ South Africa accounted for 7 percent of Malawi's exports and 40 percent of its imports in 1984 (latest data). The rand has a weight of 28 percent in the trade-weighted index of the Information Notice System, which is higher than in the currency basket of the kwacha.

Table 1. Malawi: Balance of Payments, 1981-86

(In millions of SDRs)

	1981	1982	1983	1984	1985	1986 Initial Proj.	1986 Est.
Current account	-112.8	-113.6	-134.8	-15.8	-101.4	-80.1	-85.9
Trade balance	-52.6	-57.3	-74.1	-44.6	-36.2	-18.3	-22.3
Exports, f.o.b.	244.3	219.9	215.5	308.0	246.3	245.7	222.7
Imports, c.i.f.	-296.9	-277.2	-289.6	-263.4	-282.5	-264.0	-245.0
F.o.b. value	-218.6	-179.9	-185.4	-158.0	-169.4	-161.0	-147.6
C.i.f. margin	-78.2	-97.3	-104.2	-105.4	-113.1	-103.0	-97.4
Services and transfers	-60.2	-56.3	-60.7	-60.4	-65.3	-61.8	-63.5
Nonfactor services	-7.9	-10.8	-12.6	-13.6	-13.5	-11.0	-11.3
Receipts	34.9	21.2	22.0	22.4	23.8	22.0	17.6
Payments	-42.8	-32.0	-34.6	-36.0	-37.3	-33.0	-28.9
Factor services	-70.2	-63.6	-60.0	-56.1	-56.4	-54.3	-55.2
Receipts	1.1	1.4	1.2	1.9	1.9	2.0	1.4
Payments	-71.3	-65.0	-61.2	-58.0	-58.3	-56.3	-56.6
Interest	-52.4	-38.5	-41.4	-43.3	-44.7	-42.3	-44.9
Other	-12.5	-10.9	-19.8	-14.7	-13.6	-14.0	-11.6
Private transfers	17.9	18.1	11.9	9.3	4.6	3.5	3.0
Receipts	23.0	28.7	22.5	20.6	16.2	14.4	13.4
Payments	-5.1	-10.6	-10.6	-11.3	-11.6	-10.9	-10.4
Capital account	101.1	73.3	91.9	78.6	41.4	113.6	61.9
Long-term, net	101.5	68.6	92.5	82.7	57.1	119.1	98.2
Government transfers	39.3	32.9	27.6	23.8	24.1	25.2	21.4
Credit	40.3	33.8	28.6	25.7	26.0	26.8	23.0
Debit	-1.0	-0.9	-1.0	-1.9	-1.8	-1.6	-1.6
Government loans	51.4	37.2	52.5	64.3	27.4	93.5	81.1
Credit (other)	58.4	60.3	60.8	39.9	54.8	36.2	35.9
SAL and related	21.2	18.1	--	50.6	7.2	93.0	88.9
Debit	-28.2	-41.2	-8.3	-26.2	-34.6	-35.7	-43.7
Public enterprises	3.8	-1.5	-3.6	-3.1	-0.1	-2.8	-6.6
Credit	9.0	6.8	0.7	0.7	7.0	3.1	0.9
Debit	-5.2	-8.3	-4.3	-3.8	-7.1	-5.9	-7.5
Private enterprises	7.0	--	16.0	-2.3	5.6	3.2	2.2
Credit	12.6	2.5	21.3	6.7	9.9	7.0	6.8
Debit	-5.6	-2.5	-5.3	-9.0	-4.2	-3.8	-4.6
Short-term flows and unidentified	-0.4	4.7	-0.6	-4.1	-15.6	-5.5	-36.3
Overall balance after debt relief	-11.7	-40.3	-42.9	62.8	-60.0	33.5	-24.0
Financing							
Balance	11.7	40.3	42.9	-62.8	60.0	-33.5	24.0
Use of Fund resources	27.4	-1.7	23.9	17.4	7.0	-5.3	-20.3
Change in reserves	-15.7	42.0	19.0	-80.2	53.0	-28.2	44.3
Memorandum items:							
Current account/ GDP ratios							
Excluding official transfers	-10.8	-10.7	-11.8	-1.4	-9.5	-8.1	-8.8
Including official transfers	-7.0	-7.6	-9.4	0.7	-7.3	-5.5	-6.6
Overall balance/GDP	-1.1	-3.8	-3.8	5.4	-5.6	2.1	-2.5
Gross reserves	42.2	20.5	12.8	58.0	40.1	68.3	20.0
(In weeks of c.i.f. imports)	7.4	3.8	2.3	11.4	7.4	13.4	4.2
Reserve Bank short-term external borrowing (net)	...	...	...	...	14.1	-1.4	25.1
C.i.f. margin	26.4	35.1	36.0	40.0	40.0	39.0	39.8

Sources: Data provided by the Malawian authorities; and staff estimates.

4. Central government financial operations

The program for 1985/86 (April-March) sought to reduce the deficit of the Central Government (with grants above the line) to MK 85.6 million (or 4.1 percent of projected GDP) 1/ (Table 2). Most of this deficit was expected to be externally financed, with a residual domestic financing requirement of MK 20 million. With projected nonbank financing of MK 30 million for the year, the Central Government's net position with the banking system was programmed be reduced by MK 10 million in 1985/86.

The fiscal aspects of the program for 1985/86 were designed in the light of the previous experience which pointed to persistent overruns in nonwage expenditure for purchases of goods and services, reflecting underbudgeting and weaknesses in the expenditure control system. In both 1983/84 and 1984/85 these overruns had been a major factor behind deficits that exceeded program targets by 1 percent of GDP (Chart 1), notwithstanding a better-than-projected revenue performance, and closer expenditure monitoring. The further reduction in the deficit targeted for 1985/86 was, therefore, based more on a stronger revenue effort and improved expenditure monitoring with less emphasis on expenditure restraint than in the previous two years. The established system of monthly expenditure control and monitoring was improved, and indicative targets were established for the wage bill and for total expenditure excluding debt service.

Despite this strategy, central government performance under the program in 1985/86 was disappointing, reflecting somewhat lower-than-programmed nominal revenue 2/ and significant expenditure overruns. With external financing in line with the program at 3.2 percent of GDP, domestic financing of the Central Government amounted to 5 percent of GDP, compared with the targeted 1 percent, and financing from the banking system was equivalent to 3.8 percent of GDP, or 21.4 percent of broad money at the beginning of the program year compared with a programmed contraction of 2.7 percent of broad money. Although the performance criterion for net bank credit to Government was met in June, September, and December 1985, it was exceeded by a large margin in March 1986.

Central government revenue was targeted to increase by 28.9 percent in 1985/86, with the adoption of major revenue-yielding measures arising substantially from the introduction of an export levy and a change to a more current system of collection of company taxes. 3/ However, revenue increased only by an estimated 23.3 percent, as there were shortfalls in

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1/ With grants below the line, the targeted deficit was MK 138.6 million (6.7 percent of GDP). The substantial revision in the national accounts, effected in mid-1985, complicates the comparison of economic aggregates.

2/ Relative to GDP, revenue performance was better than programmed.

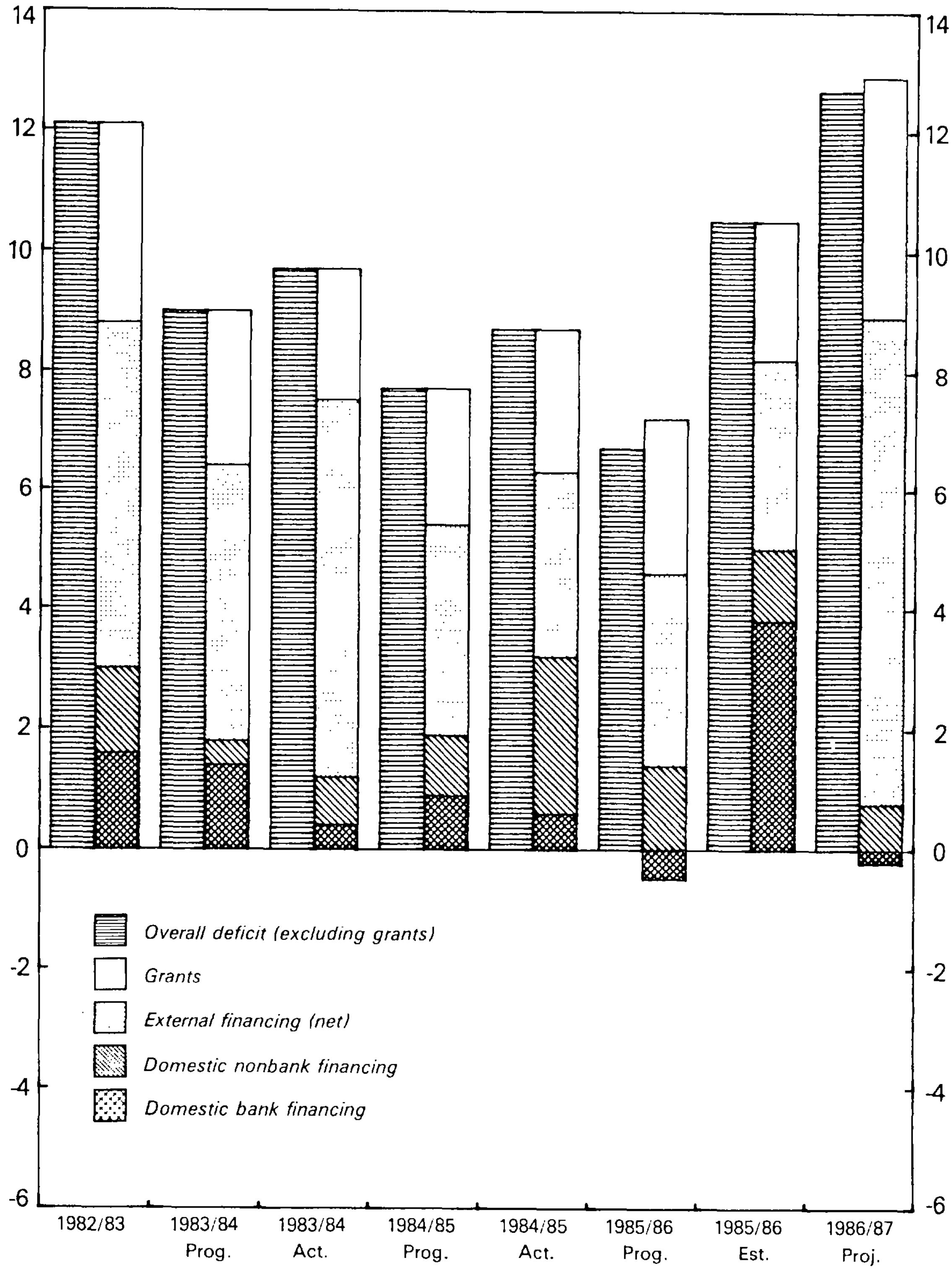
3/ See EBS/85/101, 4/24/85.

CHART 1

MALAWI

CENTRAL GOVERNMENT OVERALL DEFICIT AND FINANCING, 1982/83-1986/87

(In percent of GDP)



Sources: Data provided by the Malawian authorities; and staff estimates.

Table 2. Malawi: Summary of Central Government Operations, 1981/82-1986/87

	1981/82	1982/83	1983/84	1984/85	1985/86 Program	1985/86 Estimated outturn	1986/87 Budget	1986/87 Revised proj.
	(In millions of Malawi kwacha)							
Total revenue	220.9	244.4	286.0	353.3	455.5	435.6	512.1	499.7
Tax revenue	179.0	207.8	238.9	296.1	385.2	371.9	425.1	409.8
Nontax revenue	41.9	36.6	47.2	57.2	70.3	63.7	87.0	89.9
Total expenditure	392.7	400.3	432.0	503.2 1/	594.0	638.8	644.4	778.8
Recurrent account	268.6	260.7	289.1	364.8	412.4	436.0	458.3	484.1
Development account	124.2	139.6	142.9	138.4	181.7	164.1	186.1	168.2
Extrabudgetary ADMARC	--	--	--	--	--	26.0	--	38.5
Extrabudgetary Reserve Bank	--	--	--	--	--	12.7	--	88.0 2/
Overall surplus/deficit excluding grants	-171.8	-155.9	-146.0	-149.9 1/	-138.6	-203.2	-132.3	-279.1
Grants	42.2	41.7	33.7	40.5	53.0	44.8	54.5	87.5
Overall surplus/deficit including grants	-129.6	-114.2	-112.3	-109.4 1/	-85.6	-158.4	-77.8	-191.6
Financing	129.6	114.2	112.3	109.4	85.6	158.4	77.8	191.6
Foreign (net)	31.3	75.2	95.0	53.0	65.6	61.1	175.5	179.1
Disbursements	63.1	87.4	118.6	102.7	139.6	132.3	199.2	271.7
Amortization	-31.8	-12.2	-23.6	-49.7	-74.0	-71.2	-81.7	-92.6
Domestic	98.4	39.0	17.3	56.4	20.0	97.3	-39.7	12.5
Banking system	81.9	20.3	6.1	10.0 1/	-10.0	72.4	...	-3.5
Other	16.5	18.7	11.2	46.4	30.0	24.9	...	16.0
	(In percent of GDP)							
Revenue	19.4	18.9	19.1	20.4	21.9	22.6	25.2	22.8
Of which: tax revenue	(15.7)	(16.1)	(15.9)	(17.1)	(8.5)	(19.3)	(20.9)	(18.7)
Grants	3.7	3.2	2.2	2.3	2.5	2.3	4.3	4.0
Total expenditure	34.5	31.0	28.8	29.1 1/	28.6	33.1	31.6	35.5
Recurrent account	23.6	20.2	19.3	21.1	19.8	22.6	22.5	22.1
Development account	10.9	10.8	9.5	8.0	8.7	8.5	9.1	7.7
Extrabudgetary	--	--	--	--	--	2.0	--	5.7
Overall surplus/deficit (excluding grants)	-15.1	-12.1	-9.7	-8.7 1/	-6.7	-10.6	-6.5	-12.7 2/
Overall surplus/deficit (including grants)	-11.4	-8.8	-7.5	-6.3	-4.1	-8.2	-3.8	-8.7
Financing	11.4	8.8	7.5	6.3	4.1	8.2	3.8	8.7
Foreign	2.7	5.8	6.3	3.1	3.2	3.2	5.8	8.2
Domestic (net)	8.6	3.0	1.2	3.2	1.0	5.0	-2.0	0.5
Of which: banking system	(7.2)	(1.6)	(0.4)	(0.6)1/	(-0.5)	(3.8)	(...)	(-0.2)
Memorandum item:								
GDP (in millions of Malawi kwacha)	1,138.5	1,290.4	1,498.0	1,730.3	2,078.9	1,926.6	2,035.8	2,193.9

Sources: Data provided by the Malawian authorities; and staff estimates.

1/ Excludes MK 54.2 million issue of special local registered stock for the assumption of the debt of the Press group with domestic commercial banks.

2/ The transfer to the Reserve Bank relates to the revaluation of its net foreign liabilities arising from the depreciation of the Malawi kwacha during 1983-85. Excluding this transfer the estimate of the overall deficit for 1986/87 would be equivalent to 8.7 percent of GDP.

nontax revenue and revenue from international trade taxes. While the disappointing performance of import duties may be attributed to a shift in the composition of imports, the poor yield from the export duty can be attributed, in part, to sharply lower world tea prices, a drop in auction prices for tobacco, and a change in the incurrence of the liability to export tax from the export date (as the program assumed) to the date of repatriation of export proceeds.

More important, expenditure overruns totaled MK 45 million (equivalent to 2.3 percent of GDP). Compared with a programmed increase of 18 percent, total expenditure rose by 27 percent, to 33 percent of GDP in 1985/86. A major factor was the unprogrammed support of ADMARC, whose financial requirements increased rapidly during the early part of 1985/86 (see Section II.5 below), requiring a cash infusion for it to perform its marketing functions. As part of this infusion, the Government provided MK 26 million in July and August 1985, equivalent to 1.3 percent of GDP, which was domestically financed. Other categories of overruns were interest and other current expenditure, including transfers to the Reserve Bank (amounting to 0.7 percent of GDP) to cover its valuation losses on government paper in 1985/86.

The system of expenditure monitoring pointed to overruns in certain expenditure categories from September 1985 (particularly non-wage recurrent expenditure). Moreover, by that time, the transfer to ADMARC had been effected. It was hoped that these overruns would be corrected through budget revisions and the curtailment of benefits. In January 1986 the Government took steps to curtail sharply nonwage expenditures, especially measures to restrict staff benefits, worth an estimated MK 17 million (0.9 percent of GDP) on an annual basis. Official cars were withdrawn, the use of government vehicles was confined to office hours, telephone privileges and travel allowances were curtailed, and overtime pay was to be substituted to the extent possible by compensatory leave. However, these measures turned out to be inadequate.

To some extent, lower-than-programmed wage outlays and development expenditure offset the overruns. While this reduced the overall deficit, the reduction in development expenditure did not facilitate compliance with performance criteria on domestic bank financing, since the reduction was limited to foreign-financed expenditure and accordingly was associated with a decline in foreign project loans and grant disbursements.

5. Public enterprises

The performance of the public enterprise sector was dominated by ADMARC, which confronted severe financial problems in 1985 precipitated by large shortfalls in export earnings from maize and tobacco. These gave rise to substantial short-term borrowing from the Central Government and the banking system and to the emergence of significant domestic arrears on the part of ADMARC.

During the 1970s ADMARC's profits were largely based on a wide differential between its buying (producer) prices and selling prices for most of the smallholder crops in which it traded. By the early 1980s, ADMARC's profitability derived almost entirely from fire-cured tobacco, as the smallholders were paid less than one third of the prevailing market price. However, the producer price for tobacco was increased sharply in 1982/83, with further increases in the two subsequent years, which reduced ADMARC's profit on tobacco trading. In other crops margins were low or negative because producer prices were increased or held constant even if selling prices did not move correspondingly. When a large surplus of maize began to emerge in 1983, ADMARC was obliged by the Government to finance the construction of storage facilities and the accumulation of a large strategic grain reserve, despite declining profits.

In 1985/86 ADMARC's tobacco account swung into a loss by an equivalent of over 1 percent of GDP, because a rapid expansion in output, coupled with a decline in quality, led to a fall in auction prices while purchasing prices remained high, at least in part because of problems in ADMARCs grading. Moreover, an export levy was introduced, the burden of which for smallholder tobacco was carried wholly by ADMARC. Also, the authorities believe that there was an abnormally high degree of collaboration among the buyers to keep prices low after an initial overestimate of the crop had caused opening prices to fall sharply.

The maize account was the other major cause for concern in 1985/86. Maize was grown exclusively as a domestic food crop until surpluses emerged in 1983. Subsequently, through 1985 annual marketed production exceeded domestic consumption so that stocks accumulated, while producer prices remained largely unchanged, imposing a heavy financial burden on ADMARC. The situation was aggravated by the implicit subsidy on domestic maize sales that ADMARC carried without transfer from the Government. 1/ For 1985/86 this is estimated to have been about MK 5 million.

After incurring an overall deficit of MK 9 million in 1984/85, it was projected that ADMARC would incurr an overall deficit of MK 33 million in 1985/86 (before the reconstruction of its accounts, discussed in Section III.6 below, and excluding the advance from the Government) (Table 3). The deficit plus commitments from export prefinancing arrangements and long-term borrowing created a total domestic financing requirement of MK 45.5 million (excluding domestic arrears which amounted to MK 20 million), which was financed by a short-term advance from the Government (mentioned above), the government-guaranteed overdraft with the commercial banks, and a line of credit with the Reserve Bank. By March 1986 the cumulative short-term liabilities of ADMARC (before reconstruction of the accounts) amounted to MK 86 million

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1/ The implicit subsidy arises from the narrow spread between the producer price and the consumer price, both of which are set by the Government.

Table 3. Malawi: ADMARC Summary Accounts, 1982/83-1986/87

(In millions of Malawi kwacha)

	1982/83	1983/84	1984/85	1985/86 Est. 1/	1985/86 Prel. 2/	1986/87 Initial Proj.	1986/87 Est.
Profit (loss -) on crop trading	12.2	6.5	12.9	-15.1	-17.8	2.2	7.4
Of which: maize	(-5.8)	(-5.5)	(1.2)	(-4.1)	(-5.6)	(-2.4)	(-0.5)
tobacco	(18.6)	(13.4)	(15.7)	(-6.4)	(-7.0)	(7.3)	(7.6)
Other revenue	8.3	10.6	6.6	3.0	5.3	5.5	7.4
Other expenses	17.5	14.9	14.9	10.3	10.8	10.9	10.2
Profit (loss -)	3.0	2.3	4.5	-22.5	-19.5	-3.3	4.5
Tax (contribution to Government)	--	-4.1	--	--	--	--	--
Extraordinary items	--	-1.5	--	--	23.0	--	--
Net profit (loss -)	3.0	7.9	4.5	-22.5	3.5	-3.3	4.5
Other operations (net) 3/	-30.8	2.7	-13.6	-10.4	-21.7	49.1	39.2
Of which: Government (maize)	(--)	(--)	(--)	(--)	(-46.7) 4/	(--)	(--)
Overall surplus (deficit -)	-27.8	10.6	-9.1	-32.9	-18.2	45.8	43.7
Financing	27.8	-10.6	9.1	32.9	18.2	-45.8	-43.7
Commercial bank overdraft	8.3	-5.7	10.5	9.6	10.3	-22.4	-18.9
Reserve Bank	5.5	6.2	-1.1	8.7	8.7	-10.0	-11.2
Government	--	--	--	26.0	8.2	-8.2	-8.2
Export financing	--	4.4	4.2	-8.6	-8.6	--	--
Long-term borrowing	9.1	-9.2	-6.6	-4.0	0.3	-5.4	-5.4
Use of cash balances	4.9	-6.3	2.0	1.2	-0.7	0.2	--

Sources: ADMARC annual reports; data supplied by the Malawian authorities; and staff estimates.

1/ Prepared by the staff during the June 1986 Consultation discussions.

2/ Preliminary actual outturn; after reconstruction of ADMARC accounts.

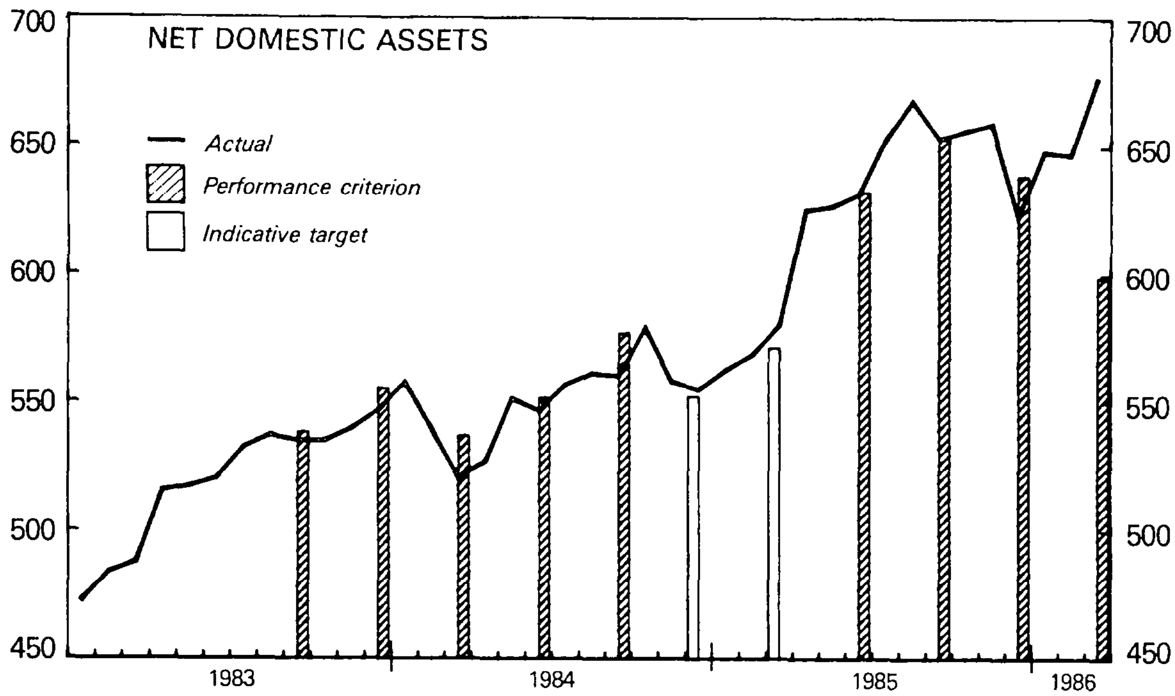
3/ Includes expenditure and net lending associated with investment, stock building, movements (net) in current assets, and arrears.

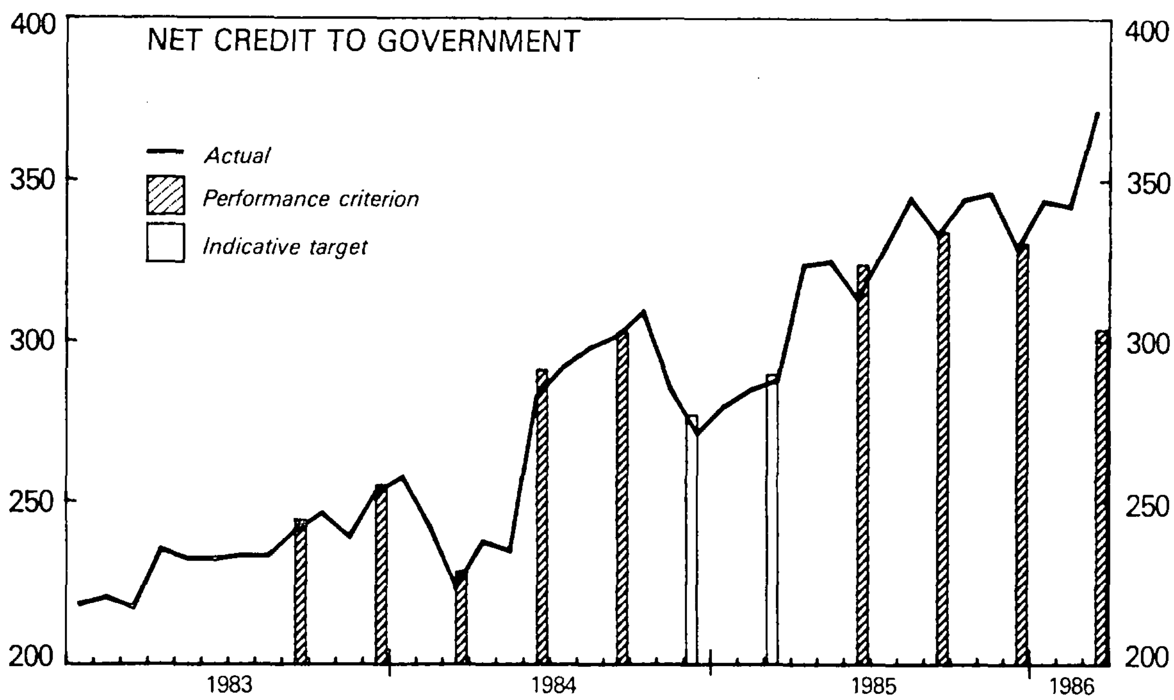
4/ Reflects the Government's purchase of the strategic grain reserve valued at cost of purchase plus recovery of previous years' costs, extraordinary items, and a reduction in net interest expenses in 1985/86.

CHART 2

MALAWI

BANKING SYSTEM NET DOMESTIC ASSETS AND NET CREDIT TO GOVERNMENT, 1983-86





Sources: Data provided by the Malawian authorities; and staff estimates.

(equivalent to 4.5 percent of GDP in 1985/86). The authorities responded to the financial crisis with assistance from the staffs of the Fund and the World Bank, so that by March 1986 a number of measures had begun to be put in place (see see Section III.6 below).

The financial difficulties of the other major public enterprises also persisted despite regular reviews and adjustments of their tariffs and prices. With the exception of the Electricity Supply Commission (ESCOM), the public enterprises have been heavily dependent on the financial support of the Central Government, as they have little access to domestic financing and in recent years have been unable to borrow externally. Government support has been in the form of deferment or nonpayment of interest due to the Government, equity conversion of large loans from the Government, assumption of servicing of government-guaranteed debt, direct advances, and government guarantees of bank overdraft facilities.

In 1985 there was an improvement in the combined profit position of the major public enterprises, largely reflecting a continued improvement in the profits of ESCOM and the Malawi Development Corporation (MDC), the latter being partly attributable to asset sales and valuation gains. ESCOM's current position benefited in 1985 from tariff increases ranging from 10 percent to 15 percent in April 1985, while MDC's position was strengthened by rationalization, disposal of assets, and price liberalization. Air Malawi and Malawi Railways, however, continued to incur large losses despite fare increases of up to 50 percent on Air Malawi's domestic routes (effective January 1985) and a uniform 15 percent increase in the domestic and international tariffs of Malawi Railways as of April 1985.

The capital expenditure of the major enterprises has been dominated by movements in ESCOM's investment outlays in recent years, because of the inability of the remaining enterprises to undertake any significant investment on account of their strained financial position. In 1985 ESCOM's capital expenditure doubled, more than offsetting the improvement in its net profit. However, its cash position, along with that of other major enterprises, remained tight.

6. Monetary and credit developments

Largely because of the developments in ADMARC and the Central Government, domestic credit expanded significantly during 1985 and early 1986, much more rapidly than had been anticipated under the extended arrangement (Chart 2). Indeed, the expansion would have been even sharper had the private sector's recourse to bank credit not been unusually low. The growth in broad money slowed markedly during 1985/86, a development associated with the worsening in the overall balance of payments.

In the first quarter of 1985/86 (March-June) there was a sharp rise in the Government's borrowing from the banks, mainly reflecting an unusually large float of expenditure carried over from the previous year. During July-September the Government extended a loan to ADMARC, mentioned above, but was able to finance this from a temporary stronger-than-expected revenue performance, and substantial use of nonbank financing, thereby avoiding excessive recourse to bank borrowing. However, the overrun on government expenditure was concentrated late in the year, and credit to the Government rose sharply in the final quarter (Table 4), even though there were large inflows of external financing. Credit to the statutory bodies rose during the first half of the fiscal year based on a pattern of financial requirements similar to those of earlier years. However, by the end of 1985/86 seasonal credit had not been unwound, even though ADMARC had had recourse to government financing and had incurred arrears which remained outstanding at year-end. Private sector credit expansion through September, although relatively slow, was consistent with past seasonal demand patterns, and outstanding credit fell in the second half of the financial year.

Between end-March 1985 and end-March 1986, money plus quasi-money fell by 3.5 percent; on average, broad money grew by 9 percent during 1985/86, compared with an average of 24 percent during 1984/85. The abrupt deceleration followed the rapid growth in 1984/85, which was attributed both to the exceptionally strong external accounts in 1984, and to domestic credit expansion in the first stages of ADMARC's liquidity difficulties in 1985. In 1985/86 the external accounts deteriorated sharply, more than offsetting the impact of domestic credit expansion on monetary growth. The authorities have ascribed a major part of the contraction in deposits (particularly of quasi-money) to the exceptionally large payments of company income tax that fell due during 1985/86. It is also possible that this low growth reflected the significant outflows of short-term capital that occurred during 1985, in part through delays or shortfalls in the remittance of export proceeds.

As part of the policy package put into place in March-April 1985, interest rates were raised by about 2 percentage points, with some change in the maturity structure of deposit rates, and remained unchanged during the remainder of 1985. There was a small modification in the system of administered rates in which the commercial banks were allowed to determine rates on deposits of less than 30 days. This resulted in a reduction of these rates, a reflection of the banks' attempts to lengthen the maturity of their liabilities. Most real interest rates were marginally positive with respect to the average inflation rate (15 percent) for 1985 and slightly more so with respect to the year-end inflation rate (12.5 percent).

Table 4. Malawi: Monetary Survey, 1983-87

(In millions of Malawi kwacha)

	1983		1984		1985				1986			1987
	Mar.	Dec.	Mar.	Dec. 2/	Mar. 3/	June	Sept.	Dec.	Mar.	June	Sept. 4/	Mar. Est. 5/
Foreign assets (net)	-172.8	-206.4	-183.7	-118.7	-161.8	-215.2	-225.4	-223.4	-304.6	-365.9	-387.1	-264.3
Gross foreign assets	39.6	31.0	57.1	98.5	51.4	83.0	74.1	86.4	61.8	52.1	46.9	...
Foreign liabilities	-212.4	-237.4	-240.8	-217.1	-213.2	-298.2	-299.5	-309.8	-366.5	-418.0	-434.0	...
Net domestic assets 1/	464.5	514.8	471.7	517.9	555.3	586.3	618.5	589.6	641.6	712.0	870.8	655.5
Net domestic credit 1/	488.4	540.1	502.9	545.1	557.5	605.8	635.5	618.5	673.5	723.7	872.2	666.5
Credit to Government (net)	217.5	252.8	223.6	271.0	298.8	312.8	333.0	328.6	371.2	377.2	523.7	374.7
Credit to statutory bodies (net) 1/	39.1	32.7	8.3	45.7	39.9	57.2	70.6	77.2	71.1	74.9	86.5	47.6
Credit to private sector	231.8	254.7	271.0	228.4	218.8	235.7	231.8	212.6	231.3	271.6	262.0	244.0
Other assets (net)	-23.9	-25.4	-31.2	-27.2	-2.1	-19.5	-16.9	-28.9	-32.0	-11.7	-1.4	-11.0
Other liabilities	51.3	47.8	46.1	47.9	55.9	9.9	-1.9	14.8	11.2	-35.2	40.9	38.4
Blocked deposits at Reserve Bank	0.6	8.1	14.0	10.0	21.4	20.9	19.4	19.6	17.6	7.7	15.3	12.8
Long-term liabilities of Reserve Bank	5.2	2.8	--	--	--	--	--	--	--	--	--	--
SDR allocation	13.3	14.9	14.9	15.5	15.4	15.4	15.4	15.4	19.6	22.8	22.8	22.8
Capital accounts	32.2	21.9	17.2	22.3	19.1	-26.5	-36.7	-20.2	-26.0	-65.7	2.8	2.8
Money plus quasi-money 1/	240.3	260.5	241.8	351.3	337.6	361.2	395.0	351.4	325.7	381.3	442.8	352.8
Money	103.2	110.5	99.4	132.5	125.4	154.8	183.2	153.5	136.2	174.8	221.6	...
Currency outside banks	44.9	50.0	42.7	56.9	53.4	75.2	85.4	66.0	59.1	81.1	96.1	...
Demand deposits 1/	58.3	60.5	56.7	75.6	72.1	79.6	97.8	87.5	77.1	93.7	125.5	...
Quasi-money 1/	137.1	150.0	142.4	218.9	212.1	206.4	211.8	197.9	189.5	206.5	221.2	...

Sources: Data supplied by the Malawian authorities; and staff estimates.

1/ The definition of this variable has been changed from previous Board papers on Malawi by the redefinition of credit to the statutory bodies on a net basis, and the removal of their deposits from monetary deposits.

2/ In June 1984 a discrete change took place in the series for credit to the private sector and to the Government, when the Government assumed the liability of the Press group to the commercial banks, a total of MK 54.2 million.

3/ In March 1985 a discrete change of MK 11.0 million occurred in the series for net credit to the Government and blocked deposits at the Reserve Bank when certain blocked accounts previously classified as government deposits (FARM accounts) were removed from the definition of net credit to the Government.

4/ During the quarter ended September 1986, the Government issued a promissory note for MK 88.3 million to the Reserve Bank in respect of revaluation losses on its net foreign assets through December 1985. Previously, this loss had been recorded in the capital accounts under the capital and reserves of the monetary authorities.

5/ Staff estimates based on developments during the first part of 1986/87.

III. Report on Discussions and Developments in 1986/87

1. Medium-term prospects

The Article IV consultation discussions in May-June 1986 took place in the context of a medium-term scenario which was prepared for a program to be supported by the use of Fund resources under a stand-by arrangement and a SAF program. That scenario has been overtaken by subsequent unfavorable developments during 1986, and the authorities have concluded that it will be necessary to prepare a revised set of policies in the context of an updated macroeconomic framework and they have indicated that they intend to do this in conjunction with the 1987/88 budget. The staff has not been able to hold discussions on a new medium-term scenario, but intends to present a revised scenario to the Executive Board at the earliest possible occasion.

The original scenario envisaged a gradual reduction in the current account deficit to about one-half of its size relative to GDP in 1985, and anticipated a large concentration of extraordinary capital inflows (primarily the World Bank's SAL and related financing) during 1986-89, part of which would be used to accumulate reserves. These flows would facilitate the adjustment measures necessary to achieve a sustainable balance of payments. These measures would have included a substantial reduction in the overall government budget deficit, improvements in the financial operations of the public enterprises (particularly ADMARC), the maintenance of an appropriate price regime (including the producer and consumer prices of the major agricultural commodities), and the implementation of flexible policies on exchange rate and interest rates. These policies were expected to contribute to savings mobilization and the diversification of the country's export base, both of which would be important to structural adjustment.

The original scenario showed gross official reserves rising to 13 weeks of imports in 1986 and to a peak of 15 weeks of imports in 1988, before declining gradually throughout the projection period to 8-9 weeks on average in 1990 and 1991, which was considered as the minimum level of reserves. The deterioration that has occurred during 1986 is substantial; it now seems likely that reserves will be equivalent to only four weeks of imports by year end. Although the reasons for the deterioration are not wholly clear, it appears that the adverse movements are not transitory. Therefore, the adjustment that will be necessary to restore viability to the balance of payments will be substantially larger than that anticipated in the initial formulation of the scenario. The staff has stressed that it is necessary for Malawi to continue its restraint on new nonconcessional borrowing in view of the present high level of the debt service ratio, which may reach a peak of 50 percent of exports of goods and nonfactor services in 1986, with only a small decline in prospect for the coming years. This is particularly so since Malawi's repurchases from the Fund will continue to be substantial, peaking at 64 percent of quota in 1987, and remaining at over 50 percent of quota annually through 1989. In 1986 gross repurchases will be equivalent to 55 percent of quota and to about 8 percent of exports of goods and nonfactor services.

2. Initial outlook for 1986/87

The authorities' original economic and financial program for 1986/87 envisaged a reduction in the external current account deficit from 9.1 percent of GDP in 1985 1/ to 8.1 percent in 1986, and a substantial overall surplus was projected in view of the very large disbursements anticipated from extraordinary financing and grants for balance of payments support. A substantial accumulation of gross official reserves was anticipated in 1986. The overall deficit of the Central Government (excluding grants) would have been reduced from 10.6 percent of GDP in 1985/86 to 7.8 percent in 1986/87, which would have permitted a reduction in the banking system's net claims on the Government equivalent to over 4 percent of GDP. The authorities also planned to undertake the financial restructuring of ADMARC, so as to eliminate the need for any further reliance on the Government for financial support, and to re-establish it as a financially viable marketing organization. Consistent with these intentions, it was expected that the net domestic assets of the banking system would contract by some 20 percent during 1986/87, and that broad money would grow by about 14 percent, approximately equal to the increase in nominal GDP.

A real growth rate of GDP of 3.0 percent in 1986, little changed from the average of the previous four years, was anticipated. Agricultural output was expected to grow by 3.5 percent, mainly attributable to the smallholder sector, where significant increases in the production of a number of crops are estimated to have occurred in response to adjustments to producer prices, as well as to favorable climatic conditions. The inflation rate, as measured by the consumer price index, was projected to fall from an average of 15 percent in 1985 to 13 percent in 1986.

3. External sector

The balance of payments in 1986 is now projected to register an overall deficit of SDR 24 million, following a deficit of SDR 60 million in 1985 and compared with the initial projection of a surplus of SDR 34 million. The current account deficit is projected to decline marginally from 9.5 percent of GDP in 1985 to 8.8 percent in 1986. Exports are projected to decline by about 10 percent during 1986, the net effect of a weakening during 1986 in the prices of tea, sugar, and maize, a decline in the volume of maize available for export, a strengthening in tobacco prices, and a substantially larger volume of groundnut exports than had been expected. The projection of imports (based on data through September) points to a decline in value of about

1/ Following revisions to the original national income accounts this figure has been revised upwards to 9.5 percent of GDP.

13 percent, in part a reflection of tighter foreign exchange allocations for private sector imports. The terms of trade are projected to decline by a further 5 percent, compared with an initially projected increase of about 6 percent and the 15 percent decline observed in 1985.

Although the net capital inflow of SDR 62 million is higher than in 1985 by some SDR 20 million, the level would have been much higher but for the large net outflows (including errors and omissions) observed in the short-term capital account. The latter appears to reflect several factors including the substitution of domestic financing for traditional sources of external prefinancing for tobacco exports, and increased lags or shortfalls in the repatriation of export proceeds. 1/ This has occurred against a background of uncertainties created by the deteriorating external security situation, the gradual devaluation of the Malawi kwacha in early 1986, and increasing lags with respect to payments by the Reserve Bank on account of private sector imports. Gross reserves of the monetary authorities fell by SDR 28.4 million in the first nine months of 1986 to a level of SDR 12 million (equivalent to 2.5 weeks of imports), despite the Reserve Bank's use of an additional SDR 25 million of its short-term credit lines with foreign banks. If external payments arrears (see below) can be reduced or eliminated, gross reserves are unlikely to exceed four weeks of imports by the end of the year, even if the short-term external bank credits are not repaid.

The authorities observed that they have adhered to a flexible approach to exchange rate policy, seeking through discretionary adjustments to improve external competitiveness. Between December 1985 and September 1986, the Malawi kwacha depreciated by 19 percent in real effective terms, and had declined to a level about 13 percent below the real effective exchange rate in April 1985 (Chart 3). This movement reflected a gradual slide in the Malawi kwacha against its currency basket early in 1986, and a single 10 percent adjustment in August 1986.

Payments by the Reserve Bank for private sector imports normally take place with a lag of about four weeks and payments for government imports with a lag of only a few days. The improvement in the reserve position which occurred in 1984 gave rise to a relaxation in import approvals under the foreign exchange budget in 1985. However, in early 1986, the foreign exchange reserves declined sharply, and the authorities were unable to provide foreign exchange within the normal time period. Consequently, by June 1986, delays of up to three months had emerged in the provision of foreign exchange for private imports, thereby constituting an intensification of exchange restrictions. These delays lengthened in subsequent months, and by September 1986 some requests for foreign exchange had been delayed for five months and the stock of arrears had risen to SDR 29 million. The Malawian authorities stated that external debt obligations have continued to be paid when

1/ Exporters are obliged to repatriate foreign exchange receipts within six months from the shipment of exports.

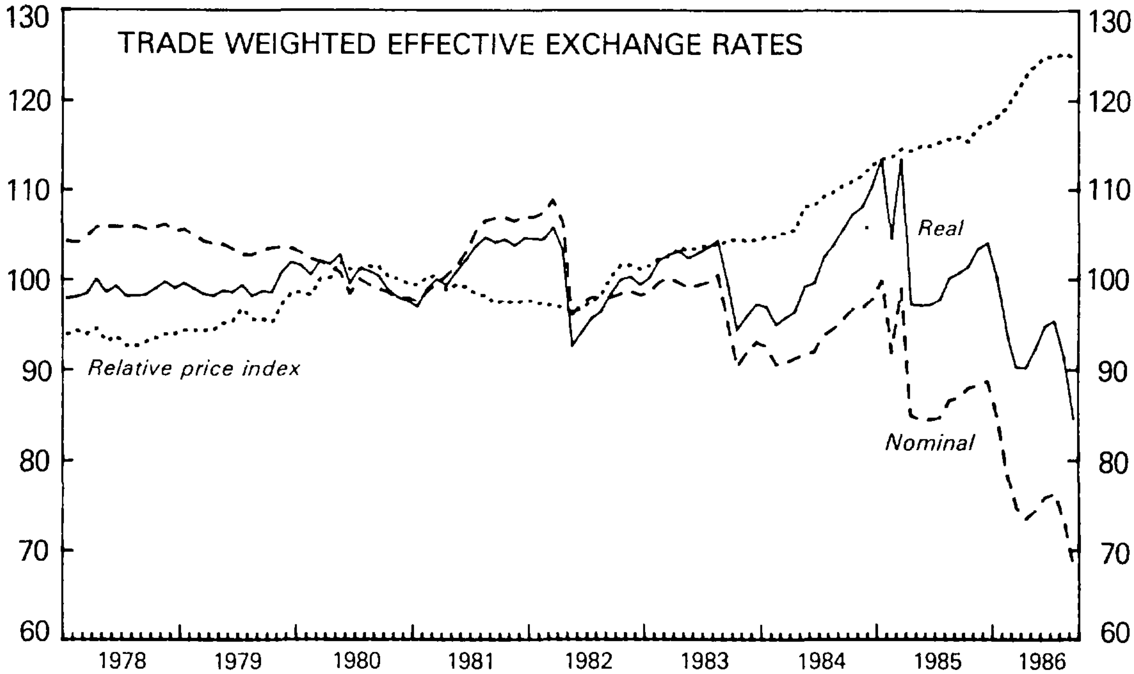
CHART 3

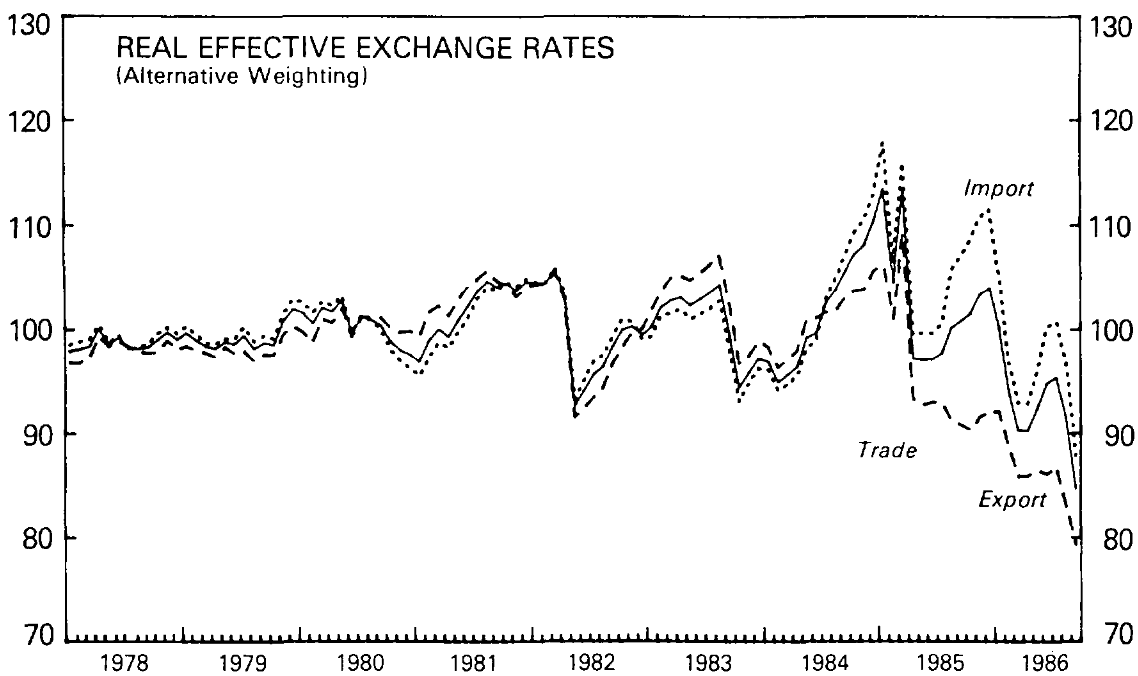
MALAWI

INDICES OF EFFECTIVE EXCHANGE RATES, JANUARY 1978-SEPTEMBER 1986

(Period average)

(1980 = 100)





Sources: IMF, *International Financial Statistics;* and staff estimates.

they become due, including financial obligations to the Fund. In addition, Malawian officials have met with foreign creditors, who have showed understanding with respect to the temporary lengthening in the payment lag. The authorities have stated that the accumulation of arrears is temporary and have indicated their expectation that all such arrears would be eliminated by December 1986 if the capital inflows now anticipated are received. The authorities are also in the process of improving the efficiency of the approval procedure in the Reserve Bank, so as to minimize administrative lags in providing foreign exchange for imports. In October 1986 the validity of import approvals granted by the Reserve Bank (for foreign exchange purposes) was reduced from six to three months, and the period after the expiry of an approval during which an extension could be requested was reduced from 21 days to 7 days.

4. Central government financial operations

The budget for 1986/87 targeted a reduction in the deficit of the Central Government (excluding grants) to 6.5 percent of GDP from 10.6 percent of GDP in 1985/86 (Table 1). Given exceptionally large projected external financing, including disbursements under the World Bank's SAL III, and a normal level of grant disbursements, this deficit target would permit a reduction in the Government's net domestic indebtedness equivalent to 2 percent of GDP.

The authorities noted that the projected improvement in the budgetary position in 1986/87 reflected an intensification of the tax and nontax effort, as well as of the expenditure control efforts. Total revenue was budgeted to increase by 2.6 percent of GDP, to 25.2 percent of GDP, in 1986/87. Tax revenue was boosted by a 5 percentage point increase in the sales tax rate on domestically produced manufactured goods and imported consumer goods, to 30 and 35 percent for basic and luxury goods, respectively. Furthermore, the budget reflected the authorities' decision to pass on to the Central Government the full savings resulting from lower oil import prices. Accordingly, the budget incorporated the transfer of the projected surplus of the Fuel Stabilization Fund in 1986/87 equivalent to 1 percent of GDP. To some extent, these revenue gains were expected to be offset by the elimination, effective April 1, 1986, of the export duties on tea and tobacco, although some further revenue was budgeted from this source in respect of declared exports for 1985/86.

The budget incorporated a reduction in total expenditure relative to GDP equivalent to 1.5 percent of GDP. In nominal terms, a small increase was budgeted for both current and development expenditure, but no provision was made in the budget for transfers to the Reserve Bank or the financial operations of ADMARC. Purchases of nonwage goods and services were budgeted to increase by a small amount, while the wage bill was budgeted to increase by 19 percent, 1/ and a reduction was anticipated in interest outlays.

Additional expenditure, which had not been included in the budget, was anticipated by the authorities for 1986/87 in connection with the rehabilitation of ADMARC. The Government had agreed in early 1986 to purchase from ADMARC 180,000 tons of maize, to constitute the strategic reserve, at a price which included the accumulated storage cost which had so far been borne by ADMARC. With the proceeds from this sale, ADMARC would repay the Government the outstanding balance on an advance received in 1985/86. These extrabudgetary transactions, which on a net basis were equivalent to 1.8 percent of GDP, would result in an increase in the deficit of the Central Government (excluding grants) to 8.4 percent of GDP, which would be entirely financed by an increase (relative to budget) in external loans and grant disbursements under SAL III and cofinancing.

The revised projections for the central government financial operations for 1986/87 (prepared during the most recent staff visit to Malawi) reflect mainly the combined impact of the gradual depreciation of the Malawi kwacha which took place in the first half of the fiscal year (about 10 percent) and the lower-than-projected imports, remaining problems in the expenditure monitoring and control system, and a further unforeseen transfer to the Reserve Bank to cover accumulated valuation losses through the end of 1985. Furthermore, total revenue had been somewhat overestimated in the original budget, reflecting in particular an overestimation of the yield of the export levy and nontax revenue, while the yields of some individual taxes appeared to have been underestimated. The authorities indicated that part of the shortfall in trade-related revenue (surtax, import duty, and export levy) would be compensated by higher-than-budgeted yields of taxes on income and profits and transfers from the Fuel Stabilization Fund. A small amount of additional revenue was also expected from an increase in the import duty applicable to a narrow range of luxury imports, effective November 1986. Finally, the authorities sought to intensify their tax assessment efforts in certain areas, where they indicated that a backlog of assessments existed. Nevertheless, for the year, a revenue shortfall of MK 12.4 million (0.6 percent of GDP) was projected.

On the expenditure side, the staff estimates conservatively that the budget expenditure estimate of MK 644 million (31.7 percent of GDP) will be exceeded by at least MK 134.5 million, of which MK 38.5 million reflects the planned extrabudgetary transactions with ADMARC and MK 88.3 million is accounted for by unbudgeted transfers to the Reserve Bank. The authorities explained that this transfer, which was in the form of a noninterest-bearing promissory note, was to cover central bank valuation losses on its foreign liabilities through the end of

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1/ The budget for 1986/87 was based on an estimated wage bill of MK 106 million in 1985. Relative to this estimate, the budgeted increase in the wage bill was 10.6 percent.

December 1985. The remaining projected overrun of at least MK 8 million on budgetary expenditure reflects sharply higher-than-budgeted current outlays (MK 26 million), which will be offset to a considerable extent by a reduction in development outlays relative to the budget estimate.

In discussing the emerging fiscal deterioration, the authorities indicated that the wage bill would be held within the budgeted amount, notwithstanding the restructuring of the civil service pay scales as well as merit increases as of August 1. While the restructuring had meant an average increase of approximately 10 percent, the merit increase amounted to approximately 5 percent. The resulting increase in the wage bill was estimated at approximately 13 percent, considering the authorities' continued policy of reducing use of nonessential staff and limiting new recruitment to a few essential positions. It appeared, however, that other current expenditure would exceed budget provisions, partly because domestic interest payments had been underestimated, but also reflecting a considerable overrun on expenditure for other goods and services. The authorities explained that when the expenditure monitoring system was put back into operation at the beginning of the fiscal year (after a lapse during the second half of 1985/86), there had been a considerably longer-than-anticipated lag in obtaining the information necessary for identifying overspending departments. Furthermore, it was noted that a centralized expenditure control system, in the sense of ex ante approval by a single ministry or office of cash expenditure or commitments, did not exist. As controlling officers of spending departments can and do exceed their monthly expenditure allocations, expenditure control can only be asserted effectively to the extent that controlling officers are held responsible for excess expenditure. In order to strengthen the control aspects of the expenditure system in 1986/87, a high level Expenditure Control Committee was established in early 1986, headed by the Secretary to the President and Cabinet. It was the intention that this committee would meet regularly and review expenditure developments and cases where budgetary limits had not been respected, and controlling officers would be held directly accountable by this committee for any expenditure overruns. However, the committee did not meet during the first half of the fiscal year, apparently because the collection of expenditure information was delayed and had not been analyzed as fully as intended.

In order to reverse a significant overrun in current expenditure in the first half of the fiscal year, the authorities explained that allocations to overspending departments would be reduced for the remainder of the year, while some cash balances would be transferred from departments which had spent less than their allocation so far. The staff cautioned that, while there appeared to be scope for some reduction in allocations to overspending departments, such reductions were unlikely to be reflected in expenditure restraint unless controls were strengthened especially at the commitment stage. Furthermore, the staff emphasized that removal of cash balances without corresponding reductions in the expenditure allocations of other departments might lead to the accumulation of domestic payments arrears. Nevertheless, the above expenditure estimate incorporates a partial reversal of the overspending which occurred through September.

The staff noted that the revised projections of the Central Government's operations for 1986/87 pointed to a deficit significantly above the budget estimate, even after allowing for the transfers to the Reserve Bank and to ADMARC (which had not been included in the original budget). 1/ Given the sharp upward revision in loans and grant disbursements relative to projection (a difference of MK 62 million), the expanded deficit 2/ would only be partly reflected in a need for domestic financing. Instead of the budgeted net reduction in outstanding domestic financing of MK 39.7 million in 1986/87, the revised projections indicate a net domestic financing need amounting to MK 12.5 million for the year (a worsening of MK 52 million), which is expected to be met from outside the banking system. In fact, a small improvement in the Government's position with the domestic banking system is still projected for 1986/87. However, in view of the difficult external position, and of the financing needs of the rest of the economy, the staff emphasized the need for a more conservative fiscal stance, and pointed out that the projections presupposed strong action to control expenditure in the second half of the fiscal year.

5. Public sector investment program

The development budget of the Central Government constitutes the public sector investment program (PSIP), which covers a rolling three-year period. The PSIP for 1986/87-1988/89 has been established following consultations with the World Bank staff in the framework of discussions relating to SAL III. Under the PSIP for 1986/87, central government development spending was projected to rise by 13 percent; assuming a 90 percent implementation rate it is now projected to rise by 2.5 percent in 1986/87. The sectoral composition of the PSIP indicates a switch to agriculture and natural resources, and reduced emphasis on transportation and other services. Nevertheless, the largest share (23 percent) of the PSIP is still budgeted for the transportation sector, with outlays on agriculture representing the second largest share at 19 percent of the total. While the share of the social services sector is being maintained at approximately 15 percent of the PSIP, within this share the budget indicates a significant shift from education outlays to the health sector.

1/ These transfers totaled MK 126 million. The transfer of MK 38 million to ADMARC had been identified shortly after the budget was presented to parliament, and the authorities had included this in the budget estimates discussed during the original consultation discussions in June 1986.

2/ Excluding the transfer to the Reserve Bank the overall deficit would be MK 59 million over the budgeted amount, of which MK 38 million is accounted for by the transfer to ADMARC.

6. Agricultural Development and Marketing Corporation

Considerable financial instability has been provoked by developments in the Agricultural Development and Marketing Corporation (ADMARC). To deal with this situation, the authorities are currently preparing an agricultural pricing and marketing reform program, and it is anticipated that it will be supported financially by the World Bank and by other donors, virtually all on concessional terms. A total of about US$50 million, in the form of a supplement to SAL III and bilateral support, is expected to be available to the Central Government for disbursement as general import support late in 1986/87 and during 1987/88.

The objective of this program is to improve the efficiency and effectiveness of the agricultural marketing system by focusing attention on three key areas. The first set of actions would seek to correct ADMARC's immediate financial difficulties, and would be designed to narrow the scope of its activities and increase managerial and operational efficiency. Second, ADMARC's future role and structure will be reviewed and redefined, with a view to increasing private sector participation in agricultural marketing. Third, a food security strategy will be developed, which will allow, inter alia, the determination of the appropriate size of the security grain reserves that should be maintained. Specific proposals touching these key areas include the following: the removal of barriers to private trade in smallholder crops; retrenchment of ADMARC's operations by large scale divestment of its portfolio of assets (shareholdings and fixed investment); rationalization of its marketing infrastructure and operations; strengthening of the business principles under which ADMARC operates as well as its corporate planning and management; increased flexibility in setting producer and consumer prices; elimination of subsidies on domestic sales and cross-subsidization among trading accounts; the subjecting of ADMARC (and other public enterprises) to income taxation; and steps to improve the quality of product handling, particularly tobacco grading.

As mentioned earlier, some of the steps to rectify ADMARC's immediate illiquidity were undertaken in 1985/86, such as the decision by the Government to purchase the strategic grain reserve and the silos in which it is stored. The authorities mentioned certain other steps, some of which were implemented early in 1986. The maize account will benefit from the ending of ADMARC's financial obligation with respect to the strategic grain reserve. Increases averaging 10 percent in the consumer prices of maize, pulses, and rice will reduce losses on domestic sales, while the movement in the exchange rate since the beginning of the year will improve the domestic currency earnings from the export of these commodities. The authorities have decided to make the remaining subsidy from the domestic sale of maize explicit in the budget for 1986/87 as a transfer to ADMARC (which will be equivalent to 0.6 percent of government expenditure). This will enable ADMARC to make its final contribution to the Fertilizer Revolving Fund. A major strengthening in the crop accounts is expected from an improvement in tobacco trading, reflecting higher quality and firmer prices.

However, a number of developments have occurred during 1986/87 that are now projected to have the effect of limiting ADMARC's overall surplus to MK 44 million, about MK 2 million less than envisaged, while its net repayments to the banking system will be about MK 5 million lower than implied by the budget estimates. With respect to maize, the estimated marketed production of 125,000 metric tons would fall short of earlier projections by over 50 percent, while domestic sales are expected to be about 25 percent higher at about 200,000 metric tons. Although export sales are expected to be less than half the earlier estimate, ADMARC's maize stocks, 1/, which were about 120,000 metric tons in March 1986, would be eliminated by March 1987. The profitability of trading in groundnuts is projected to be strengthened both by marketed production (of some 55,000 metric tons) and by export prices that now appear likely to be higher than earlier projections by about 50 percent and 20 percent, respectively. In the case of both crops, some uncertainty persists about the receipt of export proceeds by the end of the financial year in March 1987, although the authorities believe that there will be no difficulty in eventually finding markets for the entire groundnut crop.

As an initial step in the process of divesting ADMARC's nonmarketing-related assets, the authorities identified six companies, worth some MK 20 million, to be sold to the private sector. While it was initially hoped to sell these assets during 1986/87, the authorities now expect to be able to dispose only about one fourth of them. Moreover, they believe that the prospects for the eventual sale of the remaining assets has weakened. Not only will such a shortfall weaken ADMARC's financial position, but it will imply lower disbursements to the Government from a US$15 million USAID grant that is directly linked to divestment. On the basis of ADMARC's projected cash flow, it appears likely that it will be possible to clear obligations carried forward from 1985/86, and to clear export prefinancing by March 1987, although repayments to the banking system will be less than anticipated.

7. Monetary and credit policy

Credit developments for 1986/87 were expected to evolve in the light of the authorities' financial program, particularly reflecting the exceptionally large amount of external financing for the Central Government, and the projected strengthening of the financial position of statutory bodies (largely ADMARC). On the basis of assumptions underpinning the June 1986 discussions, net domestic assets were expected to contract by 34 percent of broad money between March 1986 and March 1987 with net foreign assets rising by about 37 percent of broad money, while monetary expansion would have been about 14 percent. Net bank credit to

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1/ Excluding the strategic grain reserve which is now directly owned by the Government.

government and credit to the statutory bodies were expected to fall by 31 percent and 9 percent of broad money, respectively, allowing an expansion in private sector credit of about 6 percent of broad money.

During the discussions, the authorities shared the staff's concern over the coincidence of a number of factors that would lead to an exaggeration of the usual seasonal movement of credit during the fiscal year, creating a sharp rise in domestic liquidity in the first half. This was believed to be manageable if the extraordinarily large capital inflows expected toward the end of the year were realized. The authorities recognized the importance of the timely receipt of these inflows to avoid a buildup of domestic inflationary and balance of payments pressures.

The large amount of external financing for the government budget would have been consistent with a large contraction in the banking system's net claims on the Government in the 12 months through March 1987 if the budget targets had been observed. However, about seven-eighths of the extraordinary balance of payments support is anticipated to be received between October 1986 and March 1987 while expenditure is spread relatively evenly through the year. Therefore, in the first six months of 1986/87 new credit was needed from the banking system to maintain a smooth central government expenditure pattern and to permit ADMARC to fulfill its seasonal marketing responsibility. It is noted that a significant (non-seasonal) government expenditure item in the first half-year is the payment to ADMARC for the strategic grain reserve (MK 46.7 million) which will eventually be financed by the counterpart funds from the donor-supported agricultural reform package.

The authorities observed that the expected movements in net credit to the public enterprises bodies are dominated by ADMARC. Its cash deficit normally increases progressively from April through September, when the smallholder crops are purchased, being reversed during October-March, when both export and domestic sales rise strongly. Superimposed on this is the need in 1986/87 to mobilize resources for clearing the short-term debt brought forward from 1985/86, a major part of which was to be accomplished during the first half-year. The major part of ADMARC's cash requirements was to be met by receipts from the Government in the form of payment for the strategic grain reserve, from the sale of assets to private sector enterprises, and from the use of the government-guaranteed commercial bank overdraft.

The Malawian representatives stressed that private sector demand for credit was also subject to strong seasonal fluctuations (usually peaking in the July-September quarter), principally for the financing of the tobacco trade. In the early part of the 1986/87 season (through June), they said that demand for credit was stronger than in the past two years because of substantially higher auction prices, and because there appears to be a stronger preference among traders this year for domestic borrowing as opposed to traditional offshore prefinancing, in view of the exchange rate risk following the slide of the exchange rate at the start of 1986.

During the first six months of 1986/87 (April-September), developments with respect to money and credit diverged significantly from the path implicit in the Government's financial program. The authorities acknowledge that net bank credit to Government increased at a faster rate than was consistent with the domestic financing targets of the original budget. Moreover, in the second quarter of the fiscal year the Government issued a promissory note for MK 88 million to the Reserve Bank to cover valuation losses resulting from the depreciation of the Malawi kwacha between 1982 and 1985. A sharp expansionary movement in other assets (net) of about MK 31 million also occurred. 1/ These expansionary pressures were offset partially by a fall in private sector credit during the quarter July-September, attributed by the authorities to the early repayment of seasonal credit in respect of tobacco purchases. The expansion of net credit to the statutory bodies was contained, in large part because ADMARC did not reduce its domestic arrears.

Broad money grew by 12 percent in the 12 months through September 1986, about 7 percentage points lower than the authorities had anticipated. These developments were reflected in a fall of MK 83 million in the net foreign assets of the banking system (equivalent to SDR 13 million after valuation adjustments), considerably larger than was consistent with the authorities' financial objectives. Gross official international reserves fell by MK 15 million, or SDR 9 million, in the first six months of 1986/87, and in addition external arrears of MK 63 million (SDR 29 million) had accumulated by September 1986, with about MK 40 million of the increase occurring during the quarter. 2/

Most key interest rates were positive in real terms at the end of 1985, and had been expected to remain positive through 1986, with a projected average rate of inflation of 13 percent. However, the rate of inflation rose to 15 percent in July 1986, compared with July 1985 (14 percent on the basis of annual averages). This meant that a key deposit rate had become marginally negative in real terms: 12-month deposits carry rates of 14.25 percent, lending rates are in the range 16-19 percent, while the rate on new government paper is in the range 15-16 percent. The Malawian representatives said that the authorities are committed to a regular review of interest rates in order to maintain positive real rates, and will be continuing to examine ways of introducing greater flexibility in interest rate determination.

1/ This was attributed by the authorities to unanticipated expenditure on a new note issue by the Reserve Bank of Malawi, a reduction in the tax reserves of the commercial banks, and an unusually large interbank float (possibly temporary) at end-September.

2/ Based on preliminary information, the staff estimates that about one third of these arrears are not reflected in the foreign liabilities of the banking system.

IV. Staff Appraisal

After the exceptionally favorable year of 1984, Malawi confronted a very difficult economic and financial situation beginning in early 1985. The terms of trade deteriorated sharply, export volumes of some major commodities either declined or did not grow as fast as anticipated, and import volumes were higher than programmed under the extended arrangement. These developments resulted in an external current account deficit of 9.5 percent of GDP in 1985, which was about 4 percent of GDP larger than programmed, and in a debt service ratio which rose to 39 percent of exports of goods and nonfactor services. These pressures intensified in 1986, so that by September gross reserves had fallen to little more than two weeks of imports, and delays in providing foreign exchange for import payments had begun to increase rapidly, with arrears amounting to about six weeks of imports.

Along with the weakness in the external accounts, the 1985/86 deficit of the Central Government (excluding grants), at 8.2 percent of GDP, was double the program target, as there was unprogrammed support to ADMARC and transfers to the Reserve Bank, higher-than-programmed outlays for maintenance, services and other nonwage current expenditure, and revenue shortfalls concentrated in the yield of the surtax, nontax revenue, and taxes on international trade. Moreover, in 1985/86 the deterioration in the financial situation of ADMARC, which had started in 1984/85, became more severe, owing to the combination of short-term and structural factors. In addition to borrowing from the Government this situation led ADMARC to engage in extensive short-term borrowing from the domestic banking system. As a result, in the second half of 1985/86 credit expanded more than envisaged in the program, putting pressure on the balance of payments and domestic prices.

In the face of this situation, there was no credible set of measures that could have been implemented to achieve medium-term balance of payments viability by 1986-87, as called for under the extended arrangement. Therefore, the final review under the arrangement could not be completed, and the arrangement was eventually canceled at the request of the authorities.

The staff welcomes the authorities' intention to continue their program of structural adjustment with the goal of achieving external viability and sustainable economic growth in a noninflationary environment. However, progress in this regard has been retarded by a combination of exogenous events, inadequacies in certain areas of policy implementation, and the difficulty of reacting sufficiently quickly to changing circumstances. In recent months, external political developments in the southern African region have compounded economic and financial management problems in Malawi. Although the Malawian authorities say that there has been no clear deterioration in the transportation situation thus far, they are particularly concerned about being able to have continued access to the remaining overland routes to ocean ports. Uncertainties in this area have contributed to the apparent loss of private sector confidence, which may in turn have caused the large outflows of short-term capital that began in 1985 and have accelerated in 1986. Moreover, the staff believes that the administrative and decision making capacity of Malawi may have weakened in the last two or three years, making the implementation of economic policy more difficult and further weakening confidence. The preservation of confidence is particularly important as Malawi relies on the private sector for the majority of its exports, including marketing arrangements.

The staff believes that an adjustment program would need to focus on strengthening financial discipline (including tighter control over credit aggregates), sharply reducing the overall deficit of the Central Government, and making the public enterprises profitable. It would be necessary to re-establish private sector confidence by liberalizing the trade and payments system. Greater flexibility in the use of exchange rate and interest rate policy would be an essential part of such a program. The staff welcomes the authorities' commitment to a flexible exchange rate policy and urges the authorities to monitor closely exchange rate developments, to avoid an erosion in competitiveness, and to supplement exchange rate measures by a tightening in domestic policies. A flexible exchange rate policy would contribute to the balance of payments objectives through improved export incentives, and, if coupled with appropriate producer prices and agricultural support services, would facilitate a shift in production toward nontraditional exports. Furthermore, the authorities should aim at restoring official reserves to a level which would prevent the emergence of payments delays and recourse to costly short-term credit.

A key element of structural adjustment is the financial position of the public sector. The weak revenue performance relative to the budget and significant expenditure overruns mean that the Government's overall deficit will be larger than budgeted in 1986/87. Moreover, central government revenue in 1986/87 has benefited from several temporary revenue sources, which will have disappeared by 1987/88. This underscores the need to reduce the deficit by expenditure containment or reduction in the medium term, and to reinforce this by a more effective system of expenditure control. Against this background, the staff, while recognizing the need to restructure civil service pay scales, views with concern the size of the increase in the wage bill in 1986/87. The staff endorses the Government's employment policy, which aims at streamlining the civil service, limiting recruitment to essential positions, and reducing the use of nonestablished staff.

The authorities have begun to address the serious financial situation of ADMARC. Producer prices (set in consultation with the World Bank since 1983) and selling prices have been adjusted, attempts are under way to sell assets in nonmarketing-related enterprises to the private sector, and the security grain reserve and storage silos have been sold to the Government. In conjunction with USAID and World Bank support, the subsidy on fertilizer will be phased out by 1989.

Moreover, a fundamental review of ADMARC's marketing role is under way, in consultation with the World Bank. The staff welcomes the intention of the authorities to strengthen the financial position of the other public enterprises, which will be assisted by the finding and recommendations of a World Bank study on the parastatal sector.

The staff shares the concern of the authorities at the rapid deterioration in the external accounts that has occurred since early 1985. While the forthcoming large inflows from the World Bank's SAL III are likely to provide a temporary boost to the reserve position, severe foreign exchange pressures are likely to re-emerge quickly unless decisive steps are taken to address the underlying balance of payments disequilibrium. A comprehensive and effectively implemented adjustment program is urgently called for to maintain Malawi's external financial standing and improve the confidence of the domestic private sector. The intention of the authorities to commence discussions in early 1987 on a program that can be supported by the use of Fund resources is therefore to be welcomed.

Malawi maintains restrictions under the transitional arrangements of Article XIV in respect of a foreign exchange budget for imports and limits on allowances for personal and business travel. In addition, external arrears on commercial payments arose during 1986 which constitute an exchange restriction subject to Fund approval under Article VIII, Section 2(a). The staff notes the authorities' expectation that, in view of anticipated capital inflows, these arrears will be eliminated by the end of 1986. However, in view of the uncertainties involved regarding policies that would give reasonable assurance that arrears will not re-emerge, the staff is not proposing that the Executive Board grant approval of the restriction at this time.

The staff believes that Article IV consultations with Malawi should continue on the standard 12-month cycle.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Malawi's exchange measures subject to Article VIII, Section 2(a) in concluding the 1986 Article XIV consultation with Malawi and in the light of the 1986 Article IV consultation with Malawi conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Malawi maintains the restrictive exchange measures described in SM/86/226, in accordance with Article XIV, Section 2, except that the exchange restriction evidenced by arrears on commercial payments is 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.

Malawi: Selected Economic and Financial Indicators, 1980-86

	1980	1981	1982	1983	1984	1985 EFF prog.	1985 Est.	1986 Est.
	(Annual percentage change, unless otherwise specified)							
National income								
GDP at constant factor cost	-0.9	-5.0	3.0	3.6	3.3	2.7	2.9	3.0
GDP deflator	21.7	14.9	9.8	11.0	12.8	13.9	7.4	11.8
Consumer prices	19.1	9.8	9.7	12.4	12.4	15.0	15.0	15.0
External sector								
Exports, f.o.b. (millions of SDRs)	219.1	244.3	219.9	215.5	308.0	305.7	246.3	222.7
Imports, c.i.f. (millions of SDRs)	338.0	296.9	277.2	289.6	263.4	297.4	282.5	245.0
Export volume	27.4	-19.2	-7.9	4.0	25.8	9.3	-1.3	7.4
Import volume	-5.8	-23.9	-5.0	1.5	-12.0	6.0	11.8	-2.2
Terms of trade (deterioration -)	-15.3	14.6	2.8	-5.4	10.6	-8.7	-15.3	-5.1
Nominal effective exchange rate, year-end (depreciation -)	-5.3	9.3	-8.2	-5.3	5.0	...	-9.3	...
Real effective exchange rate, year-end (depreciation -)	-4.1	7.2	-4.9	-2.3	13.4	-12.0	-5.7	...
Government budget 1/								
Revenue	6.5	10.9	10.6	17.1	23.6	30.7	23.3	14.7
Total expenditure	17.9	9.5	-2.2	14.5	12.5	20.1	26.9	21.9
Money and credit 1/								
Net domestic assets (increase) 2/	35.5	49.4	22.6	3.0	30.0 3/	1.9 4/	25.6	-4.3
Credit to Government (increase) 2/	32.4	44.5	9.6	2.5	4.1 5/	-2.7	21.4	1.1
Money and quasi-money (M2) (increase) 2/	24.1	15.2	13.4	0.6	39.6	8.9 4/	-3.5	8.3
Velocity (GDP relative to M2)		5.3	5.1	5.4	5.5	5.2 4/	5.2	5.8
Interest rate (annual rate, 12-month time deposits)	10.75	10.75	10.75	12.75	12.75	14.25	14.25	...
	(In percent of GDP)							
Central Government								
Overall deficit 1/								
Excluding official transfers	15.5	15.4	12.1	10.4	8.2 6/	6.7	10.6	12.7
Including official transfers	11.3	11.6	9.2	8.1	5.9 6/	4.1	8.2	8.7
Domestic bank financing 1/		7.3	1.6	0.4	0.6	-0.5	3.8	-0.2
Foreign financing 1/		2.8	5.8	6.4	3.1	3.5	3.2	8.2
Gross fixed capital formation	22.0	15.2	14.6	13.8	12.5	11.8	14.3	14.4
Gross domestic saving 7/	8.1	9.4	8.3	6.2	15.2	11.4	10.0	11.6
External current account								
Excluding official transfers	-20.5	-10.8	-10.7	-11.8	-1.4	-5.5	-9.5	-8.8
Including official transfers	-16.5	-7.0	-7.6	-9.4	0.7	-3.0	-7.3	-6.6
External debt (including Fund credit) (in millions of SDRs) 8/	558.0	661.8	711.6	784.8	855.4	879.9	832.6	872.3
Debt service ratio 9/	30.2	35.4	42.8	29.3	31.1	29.4	38.5	50.4
Interest payments 9/	19.0	18.8	16.0	17.4	13.1	13.8	16.5	18.7
	(In millions of SDRs, unless otherwise specified)							
Overall balance of payments	6.4	-11.7	-40.3	-42.9	62.8	-1.3	-60.0	-24.0
Gross official reserves (weeks of imports, c.i.f.)	8.6	7.4	3.8	2.3	11.4	8.8	7.2	4.2
External payments arrears (end of period)	--	--	--	--	--	--	--	...

Sources: Data supplied by the Malawian authorities; and staff estimates.

1/ Fiscal year beginning April 1 of the year indicated.
2/ As a percentage of money and quasi-money at the beginning of the period.
3/ Adjusted for the redefinition of net credit to Government which removed MK 11.0 million from government deposits.
4/ The definitions of net domestic assets and broad money used in the extended arrangement are different from the actual data reported in this table, because of the redefinition of credit to the statutory bodies on a net basis.
5/ Excludes special issue of Local Registered Stock for the Government's assumption of Press debt; including this, the change is 26.6 percent of broad money.
6/ Excluding the special issue of Local Registered Stock for the Government's assumption of Press debt.
7/ Excluding the financing of stock building.
8/ End of period, public and publicly guaranteed medium- and long-term debt.
9/ In percent of exports of goods and nonfactor services. Based on data provided by the IBRD and including IMF charges, repurchases, and estimated debt service on private debt.

MALAWI - Relations with the Fund
(At October 31, 1986)

(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

	Millions of SDRs	Percent of quota
a. Quota:	37.2	
b. Total Fund holdings of Malawi kwacha	142.03	381.81
c. Fund credit	107.03	287.72
Of which: under stand-by arrangement ordinary		
ordinary resources	7.58	20.38
SFF	11.26	30.27
enlarged access	8.24	22.15
under extended arrangement		
ordinary resources	18.53	49.81
enlarged access	38.48	103.43
compensatory financing facility	22.95	61.69
d. Reserve tranche	2.20	5.91

III. Current and previous arrangements and special facilities

	Date of arrangement	Duration (months)	Total amount	Utilization
a. Previous arrangments				
Stand-by	Oct. 1979	30	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 1/	57.0

1/ Reduced from the original amount of SDR 100 million (EBM/85/77, 5/22/85).

MALAWI - Relations with the Fund (continued)

	Date of purchase	Total amount
b. Special facilities		
Compensatory financing (exports)	Aug. 1979	9.5
Compensatory financing (exports)	Nov. 1979	8.0
	Dec. 1979	1.5
Compensatory financing (cereals)	Sept. 1981	12.0
Buffer stock financing	Dec. 1982	0.9
Compensatory financing (exports)	Mar. 1983	12.2
Compensatory financing (exports)	Aug. 1984	13.8

	Amount	Percent of allocation
IV. SDR Department		
a. Net cumulative allocation	10.98	100.0
b. Holdings	0.92	8.35

	Amount
V. Administered accounts	
a. Trust Fund loans	
(i) Disbursed	14.66
(ii) Outstanding	8.07
b. SFF Subsidy Account	
(i) Donation	--
(ii) Loans	--
(iii) Payments by Fund	3.78
VI. Overdue obligations to the Fund	None

B. Nonfinancial Relations

VII. Exchange rate arrangement

The Malawi kwacha is pegged to an unannounced basket of currencies. The intervention currency is the U.S. dollar, for which the Reserve Bank of Malawi's rates are based on the U.S. dollar/SDR rate calculated by the Fund for the preceding day. The rate on October 31, 1986 was MK 1 = US$0.4998.

MALAWI - Relations with the Fund (continued)

VIII. Last Article IV consultation and extended arrangement review

The last Article IV consultation discussions were conducted during February 15-March 1, 1985, together with a review of the arrangement and the negotiation of the program for the third financial year of the arrangement (EBS/85/101 and SM/85/121), and the following decisions were adopted:

Article IV Consultation

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Malawi in the light of the 1985 Article IV consultation with Malawi conducted under Decision No. 5392-(77/63) adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. Malawi continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV, Section 2, as described in SM/85/121. The Fund notes that Malawi's exchange system is administered in a flexible manner.

Malawi is on the standard 12-month Article IV Consultation cycle.

Review Under Extended Arrangement

1. Malawi has consulted with the Fund in accordance with paragraph 4(c) of the extended arrangement for Malawi and paragraph 31 of the memorandum attached to the letter from the Minister of Finance and the Governor of the Reserve Bank of Malawi dated June 25, 1984, attached to the extended arrangement for Malawi (EBS/83/183, Supplement 1, and EBS/84/151), in order to reach understandings with the Fund regarding policies and measures that Malawi will pursue through March 31, 1986.

2. The letter dated April 12, 1985 from the Minister of Finance and the Governor of the Reserve Bank of Malawi, together with an accompanying Economic Policy Memorandum, shall be attached to the extended arrangement for Malawi, and the letter dated July 29, 1983, together with the accompanying Economic Policy Memorandum, shall be read as supplemented by the letter dated April 12, 1985 together with the accompanying Economic Policy Memorandum.

3. Malawi will not make purchases under the extended arrangement that would increase the Fund's holdings of Malawi's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota

MALAWI - Relations with the Fund (continued)

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the ceiling on the net domestic assets of the banking system as specified in paragraphs 24 and 25 of the Memorandum attached to the letter dated April 12, 1985, or

(ii) the ceiling on the net credit to the Government of the banking system as specified in paragraphs 24 and 25 of the Memorandum attached to the letter dated April 12, 1985, or

(iii) the limit on external borrowing as specified in paragraph 10 of the Memorandum attached to the letter dated April 12, 1985,

has not been observed; or

(b) during any period after December 31, 1985, until the review with the Fund contemplated in paragraph 33 of the Memorandum attached to the letter dated April 12, 1985 has been completed, or, following that review, while any performance criteria established by the Fund pursuant to the review are not observed.

4. The extended arrangement shall be amended as follows:

(a) In paragraph 1, replace "SDR 100 million" with "SDR 81 million."

(b) In paragraph 2(b), replace "April 30, 1985" with "May 31, 1985," and "SDR 47 million" with "SDR 34 million."

(c) In paragraph 2(c), replace "April 30, 1986" with "May 15, 1986," and "SDR 83 million" with "SDR 65 million."

(d) In paragraph 2(d), replace "April 30, 1985" with "May 31, 1985," and "April 30, 1986" with "May 15, 1986."

(e) In paragraph 4(c), replace "April 29, 1985" with "May 30, 1985," and "April 29, 1986" with "May 14, 1986."

(f) At the end of paragraph 4 add the following as paragraph 4(e): "Malawi will not make purchases under this extended arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action with respect to a noncomplying purchase."

MALAWI - Relations with the Fund (concluded)

5. Until May 15, 1986, purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 65 million provided that purchases shall not exceed the equivalent of SDR 41 million until August 15, 1985, the equivalent of SDR 49 million until November 15, 1985, and the equivalent of SDR 57 million until February 15, 1986.

IX. Technical assistance, 1983-86

(a) CBD

(i) Training Advisor to the Reserve Bank of Malawi, 1982-84.

(ii) Consultant on external debt, three weeks in March-April 1984.

(iii) Consultant on the computerization of Reserve Bank operations: approximately six months from March 1985.

(iv) Administrative Advisor to the Reserve Bank; 12 months from June 1986.

(b) Budget Advisor to the Ministry of Finance, July 1985-July 1986

(c) Other - None

X. Resident Representative/Advisor

None

MALAWI - Relations with the World Bank Group

Over the past 20 years, Malawi has received 35 IDA credits and one Special Fund Credit, totaling about US$493 million, and 10 Bank loans totaling US$124 million, of which two were on third window terms. Malawi has also received an African Facility Credit totaling US$40 million equivalent. Of the total funds committed, some US$182 million (28 percent) have been for agriculture and forestry, US$108 million (16 percent) for education, US$114 million (17 percent) for roads, US$168 million (26 percent) for structural adjustment, US$39 million (6 percent) for power, US$11 million (2 percent) for water supply, and the balance of US$35 million (5 percent) for health, development finance, technical assistance, and urban housing. In addition, IFC has provided financing to Malawi for US$25.9 million, of which US$25 million were loans and the remainder equity. These funds have financed six separate projects covering a number of sectors, including textiles, sugar, ethanol production, wood industries, and tourism.

The Bank's most recent commitments to Malawi were as follows: a credit of US$11.6 million for an Agricultural Extension and Planning Support Project; a US$30 million IDA credit, and a US$40 million African Facility Credit for the Third Structural Adjustment Operation; a US$7.6 million loan for an Industrial and Agricultural Credit Project; and a loan of US$16.7 million for a Second Wood Energy Project and a credit of US$20 million for the second Lilongwe Water Supply Project.

MALAWI - Statistical Issues

1. Outstanding Statistical Issues

a. Prices

A recent technical assistance mission to Malawi (October 1986) suggested that the Retail Price Index for lower income households should continue to be published in IFS. However, this index excludes rent, resulting in the possible underestimating of inflation. A revision of this index based on the next household expenditure survey that includes housing should remedy this shortcoming.

The composite retail price index covering all income groups in Blantyre and Lilongwe would provide additional coverage and comprehensiveness if it were extended to include the Zomba and the Mzuzu indices.

b. Government finance

Malawi provides monthly, quarterly, and annual data on operations of the budgetary Central Government. Debt data are annual only. Annual local government data were also provided up to 1981 for publication in the GFS Yearbook, and an update is awaited.

c. Monetary accounts

The monetary authorities' accounts are currently under review to identify blocked deposits separately from government deposits and public entities' deposits. Since these blocked deposits relate to rescheduled external debt, a determination needs to be made as to how they may affect foreign liabilities and government and public entity accounts with the monetary authorities. In general, a detailed examination of the foreign sector accounts, particularly foreign liabilities, would be useful.

Currentness in the reporting of data for other financial institutions' accounts needs to be improved.

d. Balance of payments

Malawi has not submitted balance of payments data since August 1984. The latest data in the files of the Bureau of Statistics relate to 1982. Comments from the authorities are awaited on the tables and notes that are published on the pages for Malawi in Balance of Payments Statistics.

MALAWI - Statistical Issues (concluded)

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Malawi in the December 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Reserve Bank of Malawi, which during the past year have been provided on a timely basis, except for balance of payments data.

Status of IFS Data

		Latest Data in December 1986 IFS
Real Sector	- National Accounts	1985
	- Prices: CPI	May 1986
	- Production	June 1986
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	May 1986
	- Financing	May 1986
	- Debt: Foreign	1983
Monetary Accounts	- Monetary Authorities	August 1986
	- Deposit Money Banks	August 1986
	- Other Financial Institutions	Q3 1985
Interest Rates	- Discount Rate	August 1986
	- Bank Deposit/Lending Rates	August 1986
	- Bond Yield	n.a.
External Sector	- Merchandise Trade: Values	June 1986
	Prices: Unit Values	June 1986
	- Balance of Payments	1982
	- International Reserves	October 1986
	- Exchange Rates	October 1986