

## International Monetary Fund

[Malawi](#) and the IMF

### Press Release:

[IMF Executive Board  
Completes Third  
Review Under the  
Three-Year PRGF  
Arrangement for  
Malawi, Approves  
US\\$10 Million  
Disbursement, and  
Grants Waiver of  
Nonobservance of a  
Performance Criterion](#)  
March 14, 2007

**Malawi:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 14, 2006

The following item is a Letter of Intent of the government of Malawi, which describes the policies that Malawi intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Malawi, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

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November 14, 2006

Mr. Rodrigo de Rato y Figaredo  
Managing Director  
International Monetary Fund  
Washington, DC 20431

Dear Mr. de Rato:

1. The government of Malawi requests the completion of the third review and the fourth disbursement under the PRGF arrangement in the amount of SDR6.68 million. In this connection, the Government also requests the IMF Executive Board to grant a waiver for the nonobservance of the quantitative performance criterion relating to central government domestic borrowing for end-June 2006. The fifth disbursement will be subject to the fourth review expected to be completed in May 2007. The sixth disbursement will be subject to the fifth review to be completed in November 2007.
2. The second review of the economic program supported by Malawi's arrangement with the Fund under the Poverty Reduction and Growth Facility (PRGF) was completed on August 30, 2006. At that time, Malawi also reached the completion point under the HIPC Initiative and became eligible for relief under the MDRI. In the attached Supplement to the Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding, we review performance in implementing the program in the fiscal year 2005/06 and the first quarter of 2006/07, and update the macroeconomic framework and policy measures for 2006/07 as a whole. The Government of Malawi believes that implementation of the PRGF-supported program through end-June 2006 was satisfactory.
3. The Government of Malawi remains strongly committed to implementing the economic program supported by the PRGF arrangement. The program outlined in the attached MEFP presents quantitative performance and indicative targets through to the end of June 2007. We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the supplementary MEFP, in accordance with the agreed IMF's policies on such consultation.

4. The Government of Malawi authorizes the IMF to make this letter, the attached supplementary MEFP, and the IMF staff report available to the public, including through the IMF internet website.

Sincerely yours,

/s/  
Goodall E. Gondwe, M.P.  
Minister of Finance

/s/  
Victor Mbewe  
Governor  
Reserve Bank of Malawi

Attachments

**SUPPLEMENT TO THE MEMORANDUM OF ECONOMIC AND  
FINANCIAL POLICIES OF THE GOVERNMENT OF MALAWI**

December 20, 2006

1. **The current memorandum supplements the policies presented in our Memorandum of Economic and Financial Policies (MEFP) of July 2005 (EBS/05/113), February 2006 (EBS/06/18) and August 2006 (EBS/06/109).** This memorandum covers macroeconomic performance for FY2005/06, updates policies for FY2006/07, and outlines our structural reform agenda.
2. **We welcome the IMF Executive Board's recognition of Malawi's continued satisfactory performance under the PRGF arrangement** during its discussion of the second review in August 2006. We also welcome the recognition by the Executive Boards of the IMF and the World Bank that Malawi met the conditions to reach the completion point under the HIPC Initiative and to receive relief under the Multilateral Debt Relief Initiative.
3. **Malawi is at an important juncture.** We have made good progress in restoring macroeconomic stability, have received significant debt relief, and have recently launched the Malawi Growth and Development Strategy (MGDS). This provides Malawi with an opportunity to advance an ambitious agenda of structural reform to enhance growth. At the same time, we remain committed to sound macroeconomic policies and recognize that deepening our performance in this area will require strengthening economic management capacity.

**I. UPDATE OF 2005/06**

4. **Despite the severe challenges faced during 2005/06,** we met most of the program targets for end-June 2006. Largely because of unanticipated spending on food security, we exceeded the program targets on government domestic borrowing and discretionary government spending.
5. **Overall macroeconomic performance during 2005/06 was broadly as anticipated.** Real GDP growth was 5.3 percent, and non-food inflation fell below 13 percent. However, overall inflation remained above 15 percent, exceeding our expectations, mainly because urban food prices were slow to reflect the bumper harvest and were more susceptible to the exchange rate depreciation.
6. **Domestic borrowing, our key fiscal target, was 0.3 percent of GDP, about 0.9 percentage points higher than programmed, but domestic debt nevertheless fell below 20 percent of GDP.** Scaled-up food security operations, higher logistical costs related to the purchase and distribution of maize and fertilizer, and accelerated repayment of domestic

arrears accounted for most of the overrun. The third-quarter overrun in the wage bill was corrected in the fourth quarter, and for the fiscal year as a whole was comfortably within the program target.

7. **Pressures on the foreign exchange market eased during the second half of 2005/06.** In January 2006, we adopted a more flexible exchange rate policy and the resulting depreciation—over 12 percent by early June—helped clear the backlog of external private payment arrears by the end of July. Clearance of the backlog by end-June 2006 was delayed by weak foreign exchange inflows following the disruptions to the tobacco auctions in May.

8. **Following the reduction in the liquidity reserve ratio (LRR) in February 2006, we also tightened reserve money growth** to reduce excess liquidity and contain inflationary risks. By the end of June, we eliminated most of the excess liquidity, but not all of it as intended, so that the year ended with a modest monetary overhang. Nevertheless, broad money growth stayed largely in line with targets. As intended, lowering the LRR has eased financial intermediation costs, raising deposit rates and marginally reducing interest rate spreads. It also triggered lower yields on treasury bills, which have remained about 5 percentage points lower than at the start of the year.

## II. MACROECONOMIC POLICIES IN 2006/07

9. **The government's key macroeconomic objectives for 2006/07 are largely unchanged from those agreed under the program.** Final crop estimates have confirmed a bumper harvest that is larger than anticipated and which will support a rebound in real GDP growth above 8 percent in 2006 and to 6 percent in 2007. We have revised the fiscal year outlook for overall inflation modestly upwards to about 8 percent because of a slower than expected decline in non-food inflation.

10. **Preliminary data indicate that we met most of the indicative targets for end-September 2006.** However, the monetary program came under pressure. Although reserve money was on target, we missed the target on net foreign assets of the RBM, mainly because of unexpected administrative delays in budget support (equaling about US\$28 million), which was only partially covered by a program adjustor. As a result, we also missed the target on net domestic assets. The budget support was received in early October and we now expect to meet the monetary as well as other targets for end-December.

### A. Consolidating Debt Reduction

11. **We are committed to implementing the budget approved by Parliament in August 2006.** Preliminary data indicate that budget performance during the first quarter of 2006/07 was stronger than envisaged. Expenditures were broadly within budget, but domestic tax revenues were substantially higher than projected. The strength in tax revenues continues the strong performance in the last quarter of 2005/06 and reflects the rebound in economic activity and continued improvements in tax administration.

12. **Projections of debt service payments net of debt relief remain broadly as anticipated in the budget.** However, there is the possibility of additional debt relief during this fiscal year, as a result of topping up of HIPC debt assistance at the HIPC completion point. We welcome the decision by Paris Club creditors to provide 100 percent debt relief on pre-cutoff debt. We will approach these and other bilateral and multilateral creditors to conclude bilateral agreements on debt relief. The debt relief from the IMF under the MDRI was received by the RBM in September and November 2006. As envisaged, a portion will be transferred to the budget on a flow basis according to the former schedule of debt service payments to the IMF. In addition, the remainder will now also be transferred to the government this fiscal year and used to pay down domestic debt.

13. **We have revised our food security operations since the budget was approved.** The unexpected size of the harvest has provided us with the opportunity to increase our maize purchases to replenish the Strategic Grain Reserve, at an additional cost to the budget of about MK 0.8 billion. Part of these stocks have already been released to the World Food Program to provide humanitarian relief in areas hit by drought. In addition, to develop the capacity of the Agricultural Development and Marketing Corporation to function as a commercial entity, we have authorized it to finance its maize purchases for commercial resale through off-budget domestic commercial borrowing. We are accelerating fertilizer operations to ensure timely delivery during the crop cycle.

14. **The government payroll in 2006/07 is projected to be about 0.1 percent of GDP larger than budgeted.** This is due to additional hiring, primarily in health and education, as well as additional compensation for the judiciary and the National Assembly, pending the recommendation of the Public Service Remuneration Board. These changes will be implemented in the second half of 2006/07.

15. **We plan to securitize a portion of the stock of domestic arrears** into government bonds with a maturity of 1 to 3 years. We expect to initiate discussions with creditors and complete the securitization by end-June 2007.

16. **The outlook for the fiscal year as a whole remains positive.** We expect the strong revenue performance of the first quarter to continue. Furthermore, the World Bank is planning to provide US\$20 million in additional program support in the second half of the fiscal year. This will more than offset additional spending of about MK1.6 billion during the second half of the fiscal year. Domestic debt, excluding any securitization of domestic arrears, is now projected to fall to 14.8 percent of GDP, about 2 percentage points lower than programmed.

## **B. Reducing Inflation and Restoring External Reserves**

17. **Monetary policy remains anchored by a reserve money growth target and geared to reducing inflation.** By end-September 2006, the RBM had mopped up the excess liquidity generated by the reduction in the LRR and had brought reserve money back on

track. Because of the unanticipated monetary overhang at the end of June, we will constrain reserve money growth to ensure that the money stock target for the end of June 2007 is met. In recent months, commercial bank lending to the private sector has responded to the reduction in the LRR, lower T-bill yields, and lower banking sector financing of the budget. By the end of September, private sector credit had increased 28 percent over a year before on a seasonally adjusted basis.

18. **Overall 12-month inflation has dropped sharply since June to 11.6 percent at the end of September 2006.** Inflation nevertheless remains stronger than we had projected so that we have revised our outlook for the fiscal year upwards. Even so, the strong agricultural crop, the moderation in world oil prices, and a projected deceleration in reserve money growth are expected to push inflation below 10 percent. Lower inflation, if sustained, provides the basis for lower interest rates, but any reductions will be modest and measured and we will be prepared to raise interest rates if the inflation target comes under threat.

19. **We are committed to a flexible exchange rate policy consistent with the monetary framework and Malawi's low level of external reserves.** Net foreign assets increased steeply in September 2006, as a result of IMF debt relief under the MDRI. However, gross official reserves remained low as a result of the food crisis, the disruption to the tobacco market, and pressures on the foreign exchange market earlier this year. Restoring our import coverage remains an important priority. The stability of the exchange rate and modest appreciation since reaching the HIPC completion point will, if continued, provide opportunities to build reserves. We now expect gross official reserves to rise to about 1.7 months of imports at the end of the fiscal year, up from 1.5 months at the end of June 2006.

### III. STRUCTURAL MEASURES

20. **The MGDS provides the basis for the government to advance an ambitious medium-term agenda of structural reform.** Within the context of the PRGF-supported program, we will focus our efforts on measures to enhance growth and to strengthen our economic management capacity.

#### A. Enhancing Growth

21. **The MGDS emphasizes the need to improve Malawi's weak record on output growth by improving the environment for private sector activity.** Following consultations with the private sector and donors, we have identified five major impediments to growth: the perception of macroeconomic instability, inadequate access to credit, unreliable supply of power, the high costs of doing business, and the lack of skilled labor. We have made significant strides in restoring macroeconomic stability. To address the remaining concerns, we will, among other measures, aim to finalize a Private Sector Development Program in early 2007, whose implementation will be supported by the World Bank.

22. **Malawi ranks low on the ease of doing business** and the private sector has cited the administrative costs of dealing with public institutions as a significant burden—especially with respect to obtaining licenses, cross-border trade, and closing businesses. We have initiated steps to identify and implement measures to streamline procedures in these areas (such as consolidating business licenses) during this fiscal year. To further facilitate doing business, we are reviewing selected commercial laws in the current fiscal year.

23. **Improving access to credit is a key objective.** Continued fiscal consolidation is fundamental to this objective, as it will permit a further reduction in the government's domestic borrowing. In addition, we are developing a comprehensive strategy to strengthen financial intermediation, which will be refined after the Financial Sector Assessment Program is conducted in mid-2007. Key elements of this strategy include enhancing financial stability, strengthening creditor rights, increasing the availability of information in credit markets, and reducing intermediation costs. In addition, passage of the Land Reform Bill will increase access to collateral-based lending in the rural sector. We are also revising the RBM Act to strengthen banking supervision and, as part of a SADC initiative, to give the RBM greater autonomy. We are considering legislation to govern the microfinance sector in order to expand access to the financial sector for the rural poor (structural benchmark for end-June 2007). We have taken preliminary steps to introduce commercial courts to facilitate the resolution of commercial disputes and foster a credit culture.

24. **Improving the performance of Malawi's public sector enterprises is also key to growth.** We will continue to take steps to improve their efficiency and financial performance by introducing clear lines of accountability for responsible ministers, the Board of Directors, and chief executives and by allowing these enterprises greater operational and financial autonomy and introducing better practices. As a first step toward better monitoring the fiscal risks, we will compile quarterly financial reports for the major public sector enterprises, including the utilities and ADMARC, and publish their audited annual financial statements (structural benchmark for end-March 2007).

## **B. Building Economic Management Capacity**

25. **The progress in macroeconomic management since mid-2004** has, in large part, relied on the government taking essential steps to address an unstable macroeconomic environment. Deepening this performance will now depend on strengthening our economic management capacity.

26. **We have developed an action plan to strengthen public financial management** (structural benchmark for end-October 2006). On the basis of this action plan, we will continue the phase-in of the IFMIS and will strengthen budget comprehensiveness, internal controls and reconciliation in budget execution, and audited financial reports. We will make use of the IFMIS to ensure that the utility bills of all central government entities are paid on a timely basis (performance criterion for end-March 2007). In other areas, we will strengthen

our control of the wage bill by compiling monthly reports of payroll execution (structural benchmark for end-March 2007)

27. **An external debt management strategy** is needed to ensure that Malawi does not return to debt distress. A comprehensive strategy will take time to put in place. As a first step, we will develop and issue guidelines for the entire public sector to ensure that new borrowing is sufficiently concessional and accumulated within sustainable levels (structural benchmark for end-June 2007).

28. **Weaknesses in statistical reporting capacity impede economic management.** We are revising the national accounts and the balance of payments (with Fund technical assistance) and expect to complete these revisions by the end of the fiscal year. We will also strengthen the compilation of the consumer price index and aim to complete the revision of the weights using the 2004 Integrated Household Survey by end-June 2007. We are also improving data collection on project inflows, albeit not all donors are fully engaged.

29. **In other areas, the new travel policy focuses on accountability and transparency (structural benchmark for end-September 2006).** A circular implementing the new policy will be issued shortly in the new year. Key elements of the policy include tighter procedures for travel authorization, enhanced ex-post monitoring, audit and validation of travel claims. Daily subsistence allowances have been streamlined. The new policy aims to reduce government travel spending from about 5½ percent of total expenditure to about 3 percent.

30. **International oil prices have increased significantly in recent years and are likely to remain high into the foreseeable future.** This development represents a challenge to which we will need to adapt. The government is therefore reviewing the pricing and taxation arrangements for oil products. We are discussing options with industry participants to ensure the timely pass-through of changes in world oil prices, while smoothing the impact of sudden and large oil price shocks.

**Table 1. Malawi: Quantitative Targets<sup>1</sup>**

Criteria	Jun. 2005 Stock Actual	End-Sep. 2006				End-Dec. 2006: Test Date		End-Mar 2007	End-June 2007: Test Date	
		EBS/06/109	Adjusters	Adjusted Target	Act.	EBS/06/109	Proj.	Prog.	Prog.	
<b>I. Monetary Targets</b> (Millions of Malawi kwacha)										
1. Ceiling on net domestic assets of the monetary authorities <sup>2</sup>	PC <sup>3</sup>	15,520	-7,201	1,634	-5,567	-4,673	-2,640	-9,312	-12,499	-8,478
2. Ceiling on reserve money	IT	19,580	1,582	...	1,582	760	2,486	2,479	-623	4,183
<b>II. Fiscal Targets</b> (Millions of Malawi kwacha)										
3. Ceiling on central government's net domestic borrowing <sup>2 4 5</sup>	PC <sup>3</sup>	53,923	3,206	-2,033	1,174	-146	6,010	-806	-1,289	-5,387
4. Ceiling on central government wages and salaries <sup>4</sup>	PC <sup>3</sup>	...	26,158	-128	26,030	25,921	31,956	31,716	38,026	44,236
5. Ceiling on central government discretionary expenditures <sup>4</sup>	IT	...	73,898	1,650	75,548	72,735	90,413	92,878	108,363	120,846
<b>III. External Targets</b> (Millions of U.S. dollars)										
6. Floor on net foreign assets of the monetary authorities <sup>2</sup>	PC <sup>3</sup>	33.0	71.4	-13.3	58.1	44.2	41.7	95.9	85.2	90.9
7. Ceiling on the accumulation of external payments arrears <sup>6</sup>	PC <sup>3</sup>	...	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
8. Ceiling on new nonconcessional external debt with a maturity of one year or more <sup>5</sup>	PC <sup>3</sup>	...	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
9. Ceiling on new nonconcessional external debt with a maturity of less than one year <sup>6</sup>	PC <sup>3</sup>	...	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>										
Balance of payments support (in millions of U.S. dollars)			159.0	-10.0	...	139.6	167.4	181.1	196.1	216.1
Debt service payments to the WB and the ADB (in millions of US dollars)			7.0	3	...	10.3	7.4	10.8	11.0	11.5
IMF debt relief transfers from the RBM to the CG (in millions of US dollars)			4.5	40	...	44.7	13.2	47.4	52.1	59.9
Health SWAp wage expenditures (in millions of kwacha)			977	-128	...	849	1,230	1,102	1,360	1,621
Health SWAp ORT expenditures (in millions of kwacha)			4,413	1,650	...	6,063	7,050	7,050	8,763	10,756
Net Movement in special accounts (in millions of kwacha)			3,590	-1,698	...	1,892	1,915	2,515	2,515	1,091
Cash payment of arrears (in millions of kwacha)			2,500	0	...	3,689	3,000	4,384	4,603	4,822
Liquidity Reserve Requirement (percent)			20.0	0	...	20.0	20.0	20.0	20	20
Program exchange rate		123	123	123	123	123	123	123	139	139

PC - performance criteria; IT - indicative target

<sup>1</sup> Targets are defined in the technical memorandum of understanding (TMU).

<sup>2</sup> Targets are subject to an adjuster for BOP support.

<sup>3</sup> Targets for end-September 2006 and end-March 2007 are indicative.

<sup>4</sup> Targets are subject to an adjuster for donor-funded health expenditures.

<sup>5</sup> Targets are subject to adjusters for maize revenue and cash payment of arrears.

<sup>6</sup> Evaluated on a continuous basis.

**Table 2. Malawi: Proposed Structural Performance Criteria and Benchmarks,  
June 2006 –June 2007**

Number	Description	Date	Status
<b>Performance Criteria</b>			
1	Implementation of a centralized IFMIS mechanism for paying central government utility bills.	End-March 2007	
<b>Structural Benchmarks</b>			
1	Eliminate import backlog of commercial bank foreign exchange applications for import-related payments.	End-Jun. 2006	Implemented with a delay
2	Develop and implement new travel policy, which includes mechanisms for monitoring adherence.	End-Sept 2006	Implementation imminent
3	Formulate an action plan to address weaknesses in the area of PFM.	End-Oct. 2006	Implemented
4	Compile quarterly financial reports for key public sector enterprises and publish their audited annual financial statements.	End-March 2007	
5	Compile monthly reports on payroll execution.	End-March 2007	
6	Issue external debt management guidelines.	End-June 2007	
7	Submit legislation to Cabinet governing the microfinance sector.	End-June 2007	

## MALAWI: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the definitions for the quantitative and structural targets under which Malawi's performance under the Poverty Reduction and Growth Facility arrangement will be assessed. Monitoring procedures and reporting requirements are also specified.
2. **Coverage:** The central government includes all units of government that exercise authority over the entire economic territory. However, in contrast to the *System of National Accounts 1993 (SNA 1993)* and *Government Finance Statistics Manual 2001 (GFSM 2001)* standards, nonprofit institutions that are controlled and financed by the central government are excluded for the purposes of this memorandum. The accounts of the monetary authorities include those of the Reserve Bank of Malawi (RBM) and the central government's holdings of international reserves. Monetary aggregates under the program are based on the three-bank monetary survey.

### I. QUANTITATIVE PERFORMANCE CRITERIA

#### A. Floor on Net Foreign Assets of the Monetary Authorities

3. **Definition of net foreign assets (NFA) of the monetary authorities:** NFA of the monetary authorities are defined as the difference between gross foreign assets and liabilities. NFA will be valued in U.S. dollars, and monetary gold will be valued at the fixed RBM accounting rate. The counterpart entry to the central government's international reserve assets will be classified as a negative entry under "net credit to central government".
4. **Gross foreign assets** of the monetary authorities, or reserve assets are defined in the *International Reserve and Foreign Currency Liquidity Guidelines for a Data Template (Guidelines)*. This concept includes the following: (1) monetary gold holdings of the RBM; (2) holdings of SDRs; (3) the reserve position in the IMF; (4) central government (treasury) holdings with crown agents; and, (5) holdings of convertible, liquid, and unpledged claims on non-residents, such as deposits abroad, and foreign securities. Excluded are any foreign currency claims on residents, capital subscriptions in international institutions, assets in nonconvertible currencies, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities. It also excludes transfers of foreign currency claims to the monetary authorities by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates (*Guidelines*, Chapter 2).
5. **Gross foreign liabilities** of the monetary authorities are defined as the sum of the following: (1) outstanding liabilities of the RBM to the IMF; and, (2) all short-term foreign

currency liabilities of the RBM to non-residents with an original maturity of up to, and including, one year.

6. **Adjustment clause on net foreign assets—balance of payments support:** The floor on NFA of the monetary authorities will be adjusted upward (downward) by the full amount by which the cumulative receipts from the balance of payments support are greater (less) than the program baseline (see Table 1). The downward adjustment will be capped at US\$10 million.

7. **Definition of balance of payments support:** Balance of payments support includes all grants and foreign financing that is not linked to additional budgetary expenditure. Excluded from this definition is external project financing to fund particular activities, including food security funding from the European Union and usage of the Tokyo-Mitsubishi account, and loan financing from the IMF. Balance of payments support is measured as the cumulative flow from June 30, 2005.

8. **Adjustment clause on net foreign assets—debt service payments:** The floor on NFA of the monetary authorities will be adjusted upward (downward) by the full cumulative amount by which debt service payments to the World Bank and the ADB falls short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from June 30, 2006.

#### **B. Ceiling on the Net Domestic Assets of the Reserve Bank of Malawi**

9. **Definition of net domestic assets (NDA) of the RBM:** NDA of the RBM is defined as reserve money minus net foreign assets valued at the program exchange rate of MK139 per US\$1. Reserve money consists of currency issued by the RBM and balances of commercial banks accounts with the RBM. It includes required reserves held for Malawi kwacha deposits and any other domestic currency reservable liabilities and other demand and time deposits held with the RBM.

10. **Adjustment clause on net domestic assets—balance of payments support:** The ceiling on NDA of the RBM will be adjusted downward (upward) by the full amount by which the cumulative flow of receipts from balance of payments support is greater (less) than the program baseline. The upward adjustment will be capped at US\$10 million. Balance of payments support will be converted to Malawi kwacha using the program exchange rate (see para. 7 for the definition of balance of payments support).

11. **Adjustment clause on net domestic assets—liquidity reserve requirement:** The ceiling on NDA of the RBM will be adjusted downward for a decrease in the reserve requirement ratio, and the ceiling will be adjusted upward for an increase in the ratio. The adjuster will be calculated as follows: (one minus the percentage of reserve assets held at the discount houses) multiplied by (the program baseline required reserve ratio minus the new

required reserve ratio) multiplied by (the amount of reservable deposit liabilities in commercial banks as at the end of the quarter prior to the change in regulation).

12. **Adjustment clause on net domestic assets—debt service payments:** The ceiling on NDA of the RBM will be adjusted downwards (upwards) by the full cumulative amount by which debt service payments to the World Bank and the ADB falls short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from June 30, 2006. Debt service payments will be converted to Malawi kwacha using the program exchange rate.

### C. Ceiling on Central Government's Domestic Borrowing

13. **Definition of central government's domestic borrowing (CGDB):** CGDB is computed as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, and holdings of treasury bills minus deposits), (ii) net borrowing from commercial banks (including advances, holdings of local registered stocks and holdings of treasury bills minus deposits), (iii) net borrowing from nonbanks (including holding of local registered stocks, holdings of treasury bills, and supplier credits minus government deposits held at the Malawi Savings Bank), and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost rather than face value. Excluded are promissory notes issued to cover RBM's operational losses in 2002 and 2003. The ceiling is measured as the cumulative flow from June 30, 2005.

14. **Definition of June 2004 domestic arrears:** June 2005 domestic arrears consist of all domestic arrears for which the obligation to pay was established on or before June 30, 2004.

15. **Definition of domestic arrears:** Domestic arrears are overdue payment obligations by central government other than external payment arrears (see section I.E.), including on wages and salaries, pensions, transfers, domestic interest, goods and services, obligations arising from court cases, legally established compensation claims, and payments to the Malawi Revenue Authority (MRA) for tax refunds. Payments on wages and salaries, pensions, transfers, court established obligations, and compensations are in arrears when they remain unpaid for more than 30 days beyond their due date. Domestic interest payments are in arrears when the payment is not made on the due date. Payments for goods and services are deemed to be in arrears if they have not been made within 30 days of the date of invoice, or—if a grace period has been agreed—within the contractually agreed grace period.

16. **Adjustment clause on CGDB—balance of payments support:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the cumulative receipts from balance of payments support is greater (less) than the program baseline (see para. 7 for the definition of balance of payments support). The upward adjustment will be capped at US\$10 million.

17. **Adjustment clause on CGDB—securitization of arrears:** The ceiling on CGDB will be adjusted upward by the full amount by which pre-2005 domestic arrears are securitized.
18. **Adjustment clause on CGDB—cash payment of arrears:** The ceiling on CGDB will be adjusted downward by the full amount by which payments for verified pre-2005 domestic arrears are less than the program baseline. Only payments that are charged against the Accountant General vote, and reported by the Accountant General will be recognized as payments for pre-2005 domestic arrears.
19. **Adjustment clause on CGDB—maize revenue:** The ceiling on CGDB will be adjusted upward (downward) by the full amount by which the cumulative receipts from the sale of commercial maize through ADMARC and deposited in the RBM maize account is less (greater) than the program baseline (see Table 2).
20. **Adjustment clause on CGDB—donor pool account for the health SWAp:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the change (in kwacha) of the stock in the U.S. dollar denominated donor pool account for the health SWAp at the RBM is larger (smaller) than the change (in kwacha) of the stock in that account in the program baseline (Table 2). The change in stock is measured relative to the stock as of June 30, 2005. Stocks in the account are stated with a positive sign.
21. **Adjustment clause on CGDB—National Aids Commission (NAC) accounts:** The ceiling on CGDB will be adjusted downward (upward) by the full amount by which the change (in kwacha) of the stock in the accounts of the NAC held in the Malawi banking system is larger (smaller) than the change (in kwacha) of the stock in those accounts in the program baseline (Table 2). The stock of the NAC accounts will be determined on the basis of the quarterly financial reports of the NAC. The change in stock is measured relative to the stock as of June 30, 2005. Stocks in the accounts are stated with a positive sign.
22. **Adjustment clause on CGDB—transfer of IMF debt relief from the RBM:** The ceiling on net CGDB will be adjusted downwards (upwards) by the full amount by which the full cumulative amount of debt relief provided by the IMF under the HIPC Initiative and the MDRI at the HIPC completion point and transferred by the RBM to the Government of Malawi exceeds (falls short of) the program baseline (Table 1). The cumulative amount will be measured from June 30, 2006.
23. **Adjustment clause on CGDB—debt service payments:** The ceiling on net CGDB will be adjusted downwards (upwards) by the full cumulative amount by which debt service payments to the World Bank and the ADB falls short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from June 30, 2006.

#### **D. Ceiling on Central Government Wages and Salaries**

24. **Definition of central government wages and salaries:** Central government wages and salaries include all payments that are classified as personnel emoluments in government budgets and accounts, including payments on arrears of personnel emoluments and allowances. The ceiling is measured as a cumulative flow from June 30, 2005.
25. **Adjustment clause on central government wages and salaries—donor-funded wages and salaries in the health sector:** The ceiling on central government wages and salaries will be adjusted upward (downward) by the full amount of donor-funded supplementary wages and salaries for the health sector that is greater (less) than the program baseline (Table 2).

#### **E. Ceiling on External Payments Arrears**

26. **Definition of external payment arrears:** External payment arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements, except on external debt subject to rescheduling or restructuring. A continuous performance criterion applies on the nonaccumulation of external payment arrears on external debt contracted or guaranteed by the central government, the RBM, or other agencies on behalf of the central government or the RBM.

#### **F. Ceiling on Nonconcessional External Debt**

27. **Definition of nonconcessional external debt:** The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decisions No. 11096-(95/100), October 25, 1995; and 12274-(00/85) August 24, 2000. For program purposes, a short- and medium- and long-term debt is nonconcessional if it includes a grant element less than 35 percent, as indicated in Decision No. 11248-(96/38), April 15, 1996. The ceiling on nonconcessional debt applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf of the central government or the RBM on debt with nonresidents. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from June 30, 2005.
28. Short-term debt: outstanding stock of debt with an original maturity of one year or less.
29. Medium- and long-term debt: outstanding stock of debt with a maturity of more than one year.
30. Excluded from the limit is the use of Fund resources, and any kwacha-denominated treasury bill and local registered stock holdings by nonresidents. Excluded from the limit are

also (i) debts classified as international reserve liabilities of the RBM; (ii) new debt issued to restructure, refinance, or repay existing debt up to the amount actually used for the above-mentioned purposes; (iii) normal import financing; and (iv) arrangements to pay over time obligations arising from judicial awards to external creditors. A financing arrangement for imports is considered to be “normal” when the credit is self-liquidating.

## II. QUANTITATIVE INDICATIVE TARGETS

### A. Ceiling on Reserve Money

31. **Definition of reserve money:** Reserve money is defined as the sum of currency issued by the RBM and balances of commercial bank accounts with the RBM. It includes required reserves held for kwacha deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM.

### B. Ceiling on Central Government Discretionary Expenditures

32. **Definition of central government discretionary expenditures:** These are defined as all expenditures excluding (i) wages and salaries, (ii) interest payments, and (iii) foreign-financed development expenditures (development Part I expenditures) which are related to specific projects. Central government discretionary expenditures include statutory (i.e., nonvoted) expenditures for pensions and gratuities, and compensation and refunds; but exclude tax refunds (which are treated as a negative revenue). Central government discretionary expenditures also include other recurrent expenditures (ORT), domestically financed development expenditures (development Part II expenditures), and net lending (if any). Included in this definition are also recurrent expenditures and development Part II expenditures for which cash financing is or was made available by donors. Included in particular are all maize purchases for the Strategic Grain Reserve, purchases financed from the Japan debt relief account, and expenditures in the health sector financed from the donor pool account in the RBM for the health SWAp. The ceiling is measured as a cumulative flow from June 30, 2005.

33. **Adjustment clause on central government discretionary expenditures—donor-funded central government discretionary expenditures in the health sector.** The ceiling on central government discretionary expenditures will be adjusted upward (downward) by the full amount of donor-funded **central government discretionary** health sector expenditures that is greater (less) than the program baseline (Table 2). In respect of resources made available through the U.S. dollar-denominated donor pool account for the health SWAp at the RBM (donor pool account), donor-funded central government discretionary expenditures in the health sector will be deemed to have been made according to the calculation: ‘outflows from the donor pool account to finance expenditures, expressed in Malawi kwacha’ less ‘donor financed supplementary wages in the health sector’.

### III. STRUCTURAL PRIOR ACTIONS, PERFORMANCE CRITERIA AND BENCHMARKS

#### A. Measures Agreed Before the Third Review

34. **Travel Policy:** The Ministry of Finance will develop and implement (by issuing a circular) a travel policy that will aim to ensure accountability and control for all expenditure on travel.
35. **PFM action plan:** The Ministry of Finance will develop an action plan that prioritizes reforms, describes existing donor support, and identifies remaining areas of need for technical assistance in the area of public financial management.

#### B. Measures Agreed During the Third Review

36. **Payroll:** The Ministry of Finance will produce monthly reports on the execution of the payroll. The report will include information on the establishment, total number of employees, entries, exits, and promotions for the central government. The report will be produced within two weeks of the end of the month.
37. **IFMIS:** The Ministry of Finance will develop a mechanism within IFMIS for payment on a monthly basis of the utility bills of all central government entities (water, electricity, telephones). The mechanism will be managed by the accountant general. Implementation will be assessed by the delivery of centralized IFMIS payment receipts.
38. **Public Sector Enterprises:** The Ministry of Finance will compile quarterly financial reports of the key public sector enterprises and will publish their audited annual financial statements. The public enterprises covered include ESCOM, the five Water Boards, ADMARC, Air Malawi, the Malawi Postal Corporation, and the Malawi Housing Corporation.
39. **Microfinance sector:** The government will submit legislation to Cabinet governing the microfinance sector in Malawi. The legislation will establish the capital requirements of the microfinance institutions and provide a regulatory framework for accepting deposits and make loans. It will also provide reporting requirements to the RBM by these institutions and will establish the prudential norms under which these institutions will operate.
40. **External debt management guidelines:** The Ministry of Finance will develop and issue external debt management guidelines for the public sector (central government and public sector enterprises). The document will provide guidance on the level of concessionality at which new loans are to be contracted and the level of new borrowing. It will also outline procedures for contracting new loans through the Ministry of Finance, the responsibility of the Ministry of Finance for assessing the terms of the loan—including its concessionality—and the responsibility of the Ministry of Economic Planning and

Development in conjunction with the Ministry of Finance for evaluating the costs and benefits of the project or the use for which the loan is intended.

#### **IV. REPORTING OF CERTAIN TRANSACTIONS IN THE FISCAL ACCOUNTS**

41. **Operations of the National Aids Commission (NAC).** Financial operations of the NAC are included in the fiscal accounts according to the NAC's financial reports. Expenditures are typically classified as development Part I expenditures. Government ministries and departments that execute projects financed by NAC report these activities to NAC for inclusion in the NAC's financial reports.

42. **Donor pool funded expenditures in support of the Health SWAp.** The Government of Malawi has embarked on the implementation of an integrated program of service delivery in the health sector, the health sector wide approach (Health SWAp). In support of the Health SWAp some donors are pooling resources (the donor pool), and release these resources through normal government procedures (i.e. recurrent budget or development Part II budget) to the health sector. In order to manage the inflows of donor resources a U.S. dollar-denominated account has been set up at the RBM that holds donor pool resources until expenditures need to be financed. Donor funded expenditures for the Health SWAp from the pooled resources will be deemed to have been made in the amount of outflows from the donor pool account to finance expenditures (i.e., typically either to Malawi government No. 1 account in Malawi kwacha, or to pay directly for imports by the health sector). The attribution of donor financed expenditures to personnel emoluments, other recurrent transactions, and development Part II expenditures is made on the basis of cash flow projections and established donor commitments to finance specific expenditures (e.g., supplementary wages and salaries for professional health cadres). Typically, expenditures for other recurrent transactions are estimated as the residual of outflows less expenditures for wages and salaries less expenditures for development Part II.

#### **V. REPORTING REQUIREMENTS**

43. Monitoring of the program requires that the information listed in the tables shown below be reported to the IMF within the timeframe indicated in the table. The new data requirement for a list of the backlog of import applications for foreign exchange will include data by bank, and amounts separated by the following three categories: imports not yet delivered, imports delivered but within the grace period, and imports delivered but outside of the grace period.

## Malawi: Reporting Requirements

Data description	Data Freq.	Reporting		Delivery		
		Agency	Freq.	Lag	Date	Mode
Gross international reserves, exchange rate, and foreign exchange purchases and sales	D	RBM	W	2	F	E
Reserve money, OMO transactions, and RBM conversion of treasury bills	D	RBM	W	2	F	E
Treasury bill and RBM bill auction results	W	RBM	W	2	F	E
RBM balance sheet and broad money estimate	W	RBM	W	7	F	E
Backlog of import applications for foreign exchange	W	RBM	W	7	F	E
Four-bank monetary survey	M	RBM	M	30	30	E
International Reserve and Foreign Currency Liquidity Data Template	M	RBM	M	30	30	E
Central government domestic borrowing	M	RBM	M	30	30	E
Interest rates	M	RBM	M	30	30	E
Holdings of local registered stocks, treasury bills, and RBM bills	M	RBM	M	30	30	E
Issue and maturity profile for treasury bills and RBM bills	M	RBM	M	30	30	E
Excess reserves by bank	D	RBM	M	30	30	E
Details of project and balance of payment support	M	RBM	M	30	30	E
Monthly exchange rates	M	RBM	M	30	30	E
FCDA holdings	M	RBM	M	30	30	E
Cash flow of foreign exchange	M	RBM	M	30	30	E
Foreign exchange exposure limits by bank	M	RBM	M	30	30	E
Bank statements of both the Health SWAp and government maize account held at the RBM	M	RBM	M	30	30	E
Seven bank monetary survey and full banking survey	M	RBM	M	45	15	E
Financial soundness indicators by banks	Q	RBM	Q	45	T15	E
Insurance company survey	Q	RBM	Q	45	T15	E
Fiscal table (GFS) including revenue, expenditure, and financing.	M	MOF	M	30	30	E
Funding tables on wages, other recurrent expenditures, and development	M	MOF	M	30	30	E
CCA, supplementary CCA, and reimbursement report	M	MOF	M	30	30	E
Pro-poor spending	M	MOF	M	30	30	E
Tokyo-Mitsubishi account statements	M	MOF	M	30	30	E
Revenue data (from MRA)	M	MOF	M	30	30	E
PSI import data	M	MOF	M	30	30	E
Ministry reports on commitment and expenditures (CCS3 and CCS4 returns)	M	MOF	Q	30	T30	E
New external loans contracted or guaranteed by the central government 1/	Q	MOF	Q	30	T30	E
List of nonreschedulable external arrears by creditor 2/	Q	MOF	Q	30	T30	E
Budget execution report, including arrears and prospects for meeting budget targets based on the CCS3 and CCS4	M	MOF	Q	45	T15	E
Borrowing of the ten major parastatals 3/	Q	MOF	Q	45	T15	E
Quarterly financial statements of the ten major parastatals and MSB	Q	MOF	Q	45	T15	H
Report on PRGF performance	Q	MOF	Q	45	T15	E
Report on verified pre 30. June 2004 expenditure arrears	Q	AuG	Q	45	T15	E
Report on new post 30. June 2004 arrears verified by AuG	Q	AuG	Q	45	T15	E
Annual audited financial statements of the ten major parastatals and MSB	A	MOF	A	90	Mar. 30	H
Consumer price index and monthly statistical bulletin	M	NSO	M	30	30	E
Import and export data	M	NSO	M	45	T15	E
Balance of payments, and quarterly statistical bulletin	Q	NSO	Q	45	T15	E
National accounts, balance of payments, and quarterly statistical bulletin	A	NSO	BA	45	Mar. 15; Sep. 15	E

D-Daily, W-Weekly, M-Monthly, Q-Quarterly, BA-Bi-annual A-Annual; F-Friday, 30-Every 30th, T30-Every third 30th; E-Electronic, H-Hard copy  
1/ Detailed information on the amounts, currencies, terms, and conditions, including debt contracted or guaranteed by the RBM or any other agency on behalf of the central government.

2/ To be reported by DAMD, including a detailed explanation.

3/ Agriculture Development and Marketing Corporation, Air Malawi, Electric Supply Company of Malawi, Malawi Development Corporation, Malawi Housing Corporation, Malawi Postal Corporation, Malawi Telecommunications Ltd., Northern Regional Water Board, Central Regional Water Board, and Southern Region Water Board.

**Table 1. Malawi: Program Balance of Payments Support and Debt Service Obligations, FY2005/06 and FY2006/07**  
(Millions of U.S. dollars)

	FY05/06								FY06/07					
	Q1		Q2		Q3		Q4		Q1		Q2		Q3	Q4
	EBS/05/113	Act.	EBS/05/113	Act.	EBS/06/18	Act.	EBS/06/18	Act.	EBS/06/109	Act.	EBS/06/109	Proj.	Prog.	Prog.
<b>Balance of payments support</b>														
Grants	60.2	35.7	20.0	52.7	3.0	3.0	28.1	19.0	21.2	4.7	0.0	41.5	15.0	0.0
EU	18.8	0.0	0.0	17.5	0.0	0.0	28.1	19.0	0.0	0.0	0.0	13.1	2.6	0.0
IDA	0.0	0.0	20.0	29.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
UK	38.2	35.7	0.0	0.0	0.0	0.0	0.0	0.0	17.5	0.0	0.0	28.4	9.3	0.0
Norway	3.2	0.0	0.0	5.3	3.0	3.0	0.0	0.0	3.7	4.7	0.0	0.0	3.2	0.0
Loans	0.0	0.0	25.0	0.0	25.0	0.0	0.0	24.5	0.0	0.0	8.4	0.0	0.0	20.0
IDA	0.0	0.0	25.0	0.0	25.0	0.0	0.0	24.5	0.0	0.0	0.0	0.0	0.0	20.0
ADB	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.4	0.0	0.0	0.0
Total	60.2	35.7	45.0	52.7	28.0	3.0	28.1	43.5	21.2	4.7	8.4	41.5	15.0	20.0
Cumulative total	60.2	35.7	105.2	88.4	116.4	91.4	144.5	134.9	159.0	139.6	167.4	181.1	196.1	216.1
<b>Debt service payments</b>														
IDA									5.1	5.1	0.2	0.4	0.3	0.4
AfDB									1.9	5.2	0.2	0.0	0.0	0.0
Total									7.0	10.3	0.4	0.4	0.3	0.4
Cumulative									7.0	10.3	7.4	10.8	11.0	11.5
<b>Pass-through of debt relief from the RBM to the GoM</b>														
IMF									4.5	44.7	8.7	2.7	4.7	7.8
Cumulative									4.5	44.7	13.2	47.4	52.1	59.9

Sources: IMF, UK, EU, Norway, AfDB, and WB.

**Table 2. Malawi: Program Maize revenue, Health SWAp, and NAC Funds, FY2005/06 and FY2006/07**  
(Millions of Malawi Kwacha)

	FY05/06								FY06/07					
	Q1		Q2		Q3		Q4		Q1		Q2		Q3	Q4
	EBS/05/113	Act.	EBS/05/113	Act.	EBS/06/18	Act.	EBS/06/18	Act.	EBS/06/109	Act.	EBS/06/109	Proj.	Prog.	Prog.
<b>Maize revenue</b>														
Quarterly receipts	170	300	334	454	391	298	0	124	40	0	320	0	0	0
Cumulative receipts	170	300	504	753	1,157	1,051	1,157	1,175	1,091	1,175	1,411	1,175	1,175	1,175
<b>Health SWAp</b>														
<b>RBM accounts</b>														
Revenues	754	1,488	1,840	584	883	2,102	2,159	2,067	2,163	819	928	1,863	1,970	2,045
Expenditures	1,193	1,556	1,227	0	1,164	952	1,882	2,883	0	1,732	2,923	1,240	1,970	2,254
Change in account balance	-439	-67	613	584	-281	1,150	277	-816	2,163	-912	-1,995	623	0	-209
Cumulative receipts	754	1,488	2,594	2,073	2,980	4,175	5,139	6,242	7,955	7,062	8,883	8,925	10,895	12,939
Cumulative expenditures	1,193	1,556	2,420	1,556	2,721	2,507	4,603	5,390	5,457	7,122	8,379	8,362	10,332	12,586
Cumulative change in account balance	-439	-67	174	517	259	1,668	536	852	2,498	-60	503	563	563	354
<b>Fiscal accounts</b>														
Wage expenditures	177	138	181	199	184	159	408	106	247	247	253	253	257	261
ORT Expenditures	1,016	1,417	1,046	-199	980	793	1,474	3,066	-247	986	2,637	987	1,713	1,993
Cumulative fiscal expenditures	1,193	1,556	2,420	1,556	2,721	2,507	4,603	5,679	5,390	6,913	8,280	8,153	10,123	12,376
Cumulative wage expenditures	177	138	358	337	322	496	730	602	977	849	1,230	1,102	1,360	1,621
Cumulative ORT expenditures	1,016	1,417	2,062	1,218	2,399	2,011	3,873	5,077	4,413	6,063	7,050	7,050	8,763	10,756
Inflows to RBM (US\$ millions)	5.9	12.1	14.1	4.7	6.6	16.2	15.8	15.0	10.4	5.9	20.6	13.4	13.9	14.2
Cumulative inflows	5.9	12.1	20.0	16.8	23.6	33.0	39.4	48.0	49.8	53.9	70.4	67.3	81.2	95.4
<b>National AIDS Commission (NAC)</b>														
<b>NAC Accounts</b>														
Revenues	1,269	455	1,309	1,928	1,340	264	1,364	508	1,413	1,745	1,445	3,475	1,027	20
Expenditures	1,269	768	1,309	1,706	1,340	506	996	614	1,413	530	1,445	3,475	1,027	1,235
Change in account balance	0	-313	0	222	0	-241	368	-106	0	1,215	0	0	0	-1,215
Cumulative change in account balance	0	-313	0	-91	-368	-333	0	-438	0	776	0	776	776	-438
Inflows to RBM (US\$ millions)	10.0	2.6	10.0	2.1	10.0	0.2	10.0	0.2	10.0	10.7	10.7	14.4	7.0	0.0
Cumulative inflows	10.0	2.6	20.0	4.6	14.6	4.8	24.6	5.0	34.6	15.7	45.3	30.1	37.1	37.1