REPUBLIC OF MALAWI

MINISTRY OF FINANCE, ECONOMIC PLANNING & DEVELOPMENT

2017/18 PUBLIC DEBT REPORT

SEPTEMBER 2018

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PREFACE

The Debt and Aid Management Division is the primary agent of the Government of Malawi responsible for contracting and managing the country's public debt. It is responsible for the compilation and dissemination of public debt statistics. Comprehensive and timely public sector debt statistics allow government and other stakeholders to monitor the evolution of the Government of Malawi's public sector debt liabilities and debt-service obligations over time. Debt statistics provide early warning signals of possible debt-servicing problems and serve as an indicator of the sustainability of government and public corporations' activities. In addition, public debt statistics serve as essential inputs for government budget preparation, and for the execution, forecasting and compiling of other macroeconomic statistics.

This report is a review of Malawi's external and domestic debt portfolios and provides risk analysis on these portfolios for the period July 2017-June 2018. The external debt portfolio review focuses on the evolution and composition of debt by creditor and by currency. The domestic debt portfolio review focuses on the main instruments and holders of debt. The risk analysis gives an assessment of the risks associated with the external and domestic debt portfolios.

The scope of this debt report is public and publicly guaranteed (PPG) debt where public debt comprises Central Government debt and public financial institution debt namely Reserve Bank of Malawi (RBM). In terms of valuation, External Debt Stock is reported as Disbursed Outstanding Debt whilst Face Value is used for domestic debt.

The Debt and Aid Management Division wishes to acknowledge United Nations Development Programme (UNDP) and European Union for the financial support in publishing this report. An electronic version of this Report is available on the Ministry's website: www.finance.gov.mw.

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A. INTRODUCTION

1. This report provides an update on the status of public debt in Malawi as at end June 2018 by evaluating the status of its associated costs. The report also presents the current challenges the country faces with its debt management, the risks associated with the current debt portfolio, and the potential implications in light of the IMF's Extended Credit Facility (ECF) Program.

B. TOTAL PUBLIC DEBT STOCK

2. As of end June 2018, Malawi's Total Public Debt amounted to MK2.9 trillion (refer Table 1). External and Domestic Debt accounted for 50.1 percent and 49.9 percent of the total debt, respectively. In terms of Gross Domestic Product (GDP), Total debt as a percentage of GDP in nominal terms was at 56.8 percent (of which, external debt was at 28.4 percent and domestic debt was at 28.3 percent).

Table 1: Evolution of Public Debt (in Billions)

	2005	2006 (HIPC)	2013	2014	2015	2016	2017	2018
Total Public Debt (MK)	427	131	913	1,336	1,710	2,082	2,752	2,999
External (USD)	2.97	0.45	1.42	1.8	1.8	1.8	2.02	2.1
External (MK equivalent)	353	62	523	877	1,135	1,300	1,476	1,502
Domestic (MK)	73	69	390	487	526	806	1,286	1,497
Debt (% of GDP)	130.5	30.4	78.8	52.7	55.0	53.5	59.4	56.8

Source: Ministry of Finance, Economic Planning & Development

C. EXTERNAL PUBLIC DEBT

3. As of June 2018, the total disbursed outstanding external debt stock totalled USD2.1 billion (MK1.5 trillion). Multilateral creditors continued to account for the largest proportion of Malawi's external debt at approximately 79.3 percent (US$1.642 billion). On the other hand, bilateral creditors accounted for 20.7 percent of all external debt (US$427.4 million). As of end June 2018, Central Government owed no debt to commercial creditors.

Table 2: End June 2018 -External Debt Stock by Creditor Type (US$ in millions)

Multilateral	1,642.1	79.3%
Bilateral	427.4	20.7%
Total	**2,069.5**	**100.0%**

Source: Ministry of Finance, Economic Planning & Development

4. As depicted in Table 3 below, the top five external creditors to Malawi are World Bank (represented as the International Development Association (IDA)); African Development Bank (represented as African Development Fund (ADF)); Export Import Bank of China (Mainland); the International Monetary Fund; and Export Import Bank of India, respectively. At approximately 43.2 percent of total external public debt, IDA remains the largest creditor to the Government of Malawi. This notwithstanding, bilateral donors notably China and India have significantly

increased their loans to the country in recent years. It is envisaged that this trend will continue in the near term.

Table 3: End June 2018 - Total External Debt by Holder(US$)

Creditor	**Debt Outstanding (US$) in million**	**%**
International Development Association	893.5	43.2
African Development Fund	304.0	14.7
People's Republic of China	227.1	11.0
International Monetary Fund	222.8	10.8
Export Import Bank of India	140.9	6.8
International Fund for Agric. Development	78.4	3.8
OPEC Fund for International Development	58.5	2.8
Kuwait Fund for Arab Economic Development	44.6	2.2
Arab Bank for Economic Development in Africa	44.4	2.1
Nordic Development Fund	22.6	1.1
European Investment Bank	17.9	0.9
Saudi Fund for Development	6.7	0.3
Abu Dhabi Fund for Development	5.5	0.3
Government of Belgium	1.6	0.1
Taiwan	1.0	0.0
Total External Debt	**2,069.5**	**100**

Source: Ministry of Finance, Economic Planning & Development

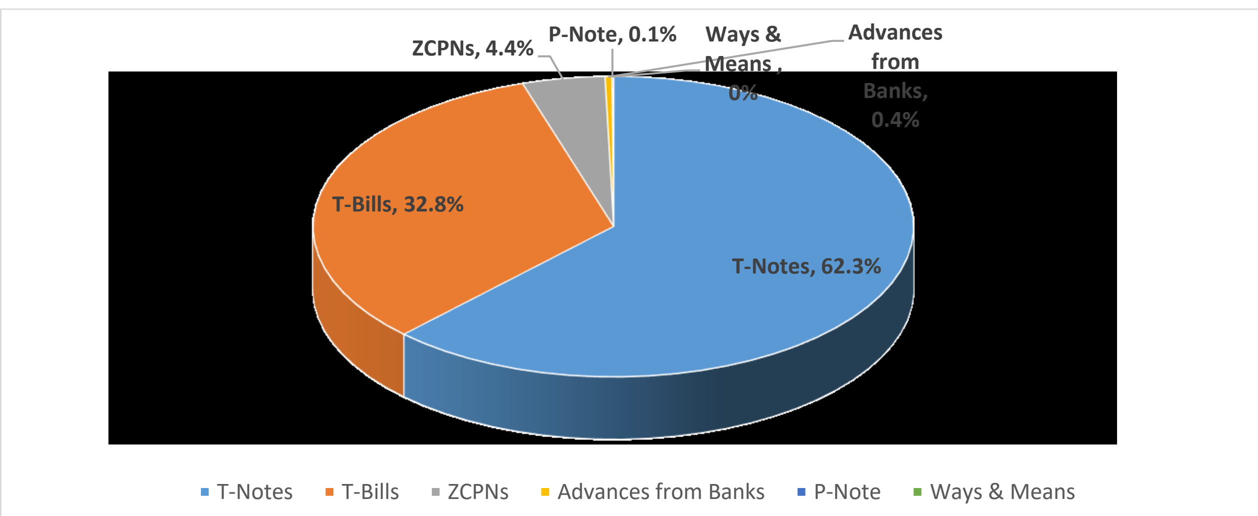
D. DOMESTIC PUBLIC DEBT

5. The Government of Malawi (GoM) borrows domestically for various reasons. Firstly, and most typically, GoM borrows from domestic sources to finance the budget deficit which arises when the Government is not able to meet its expenditure commitments using domestically raised revenue and externally sourced grants

and borrowing. Secondly, domestic debt is sometimes contracted by the Reserve Bank of Malawi when implementing monetary policy through Open Market Operations (OMO). Thirdly, debt instruments are important in financial market development and such may be contracted as a means to further develop Malawi's domestic debt market.

6. As at end June 2018, the principal on Malawi's domestic debt stock amounted to MK1.5 trillion (including Zero Coupon Promissory Notes (PN)). This stock amount comprised 62.27 percent in Treasury Notes; 32.82 percent in Treasury Bills; 4.4 percent in Zero Coupon PNs; 0.38 percent in Advances from Commercial Banks and 0.08 percent in Promissory Notes. Figure 1 below summarizes this decomposition by instrument.

Figure 1: End June 2018 - Domestic Debt Stock by Instrument



Source: Ministry of Finance, Economic Planning & Development

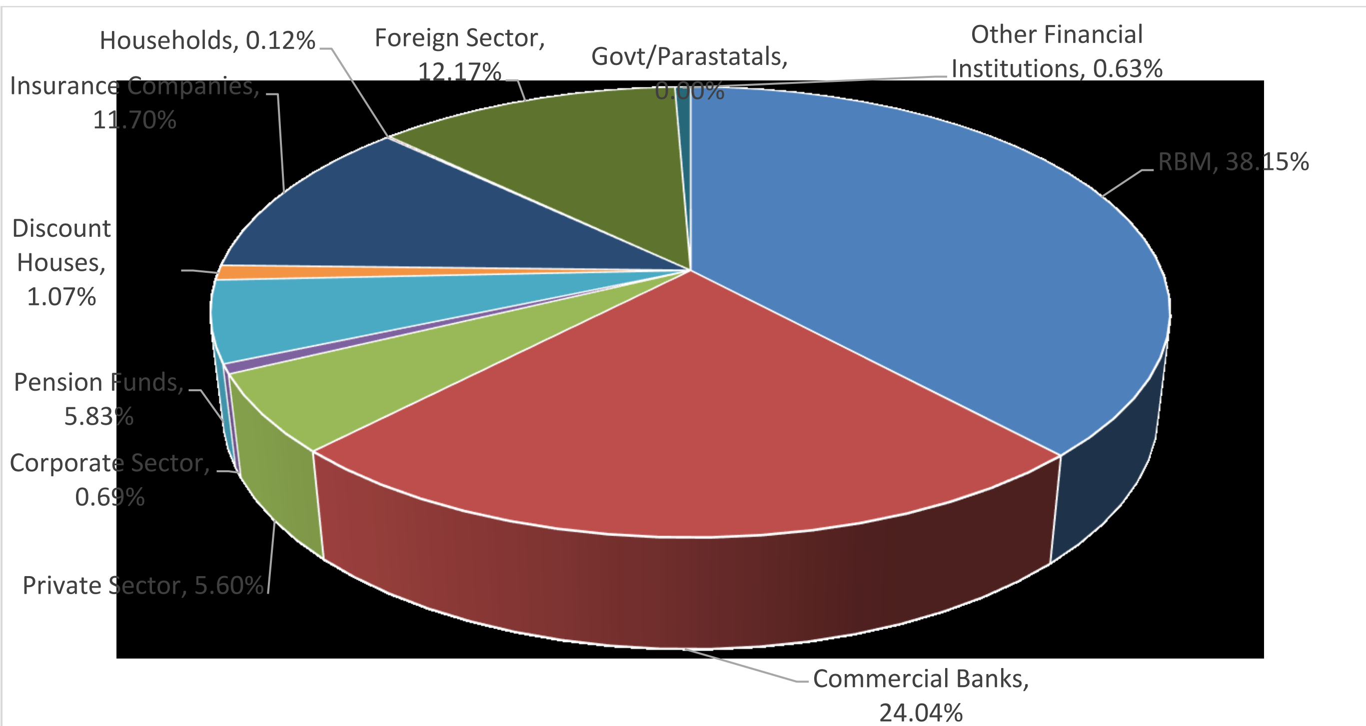
7. During the year ending 30th June 2018, domestic debt securities (including Zero Coupon Promissory Notes) amounted to MK1.5 trillion in face value. Of this amount: 38.15 percent were held by RBM; 24.04 percent by commercial banks; 12.17 percent by the foreign sector; 11.7 percent by insurance companies; 5.83 percent by pension funds; and 5.6 percent by the private sector. It should be noted that RBM's holding of Government debt significantly reduced from 60 percent recorded as at end June 2017 to 38.15 percent as at end June 2018.

8. Deliberate efforts were put in place to achieve this reduction since large proportions of Government debt held by central banks, create a highly monetised debt stock that has both direct and indirect impact on interest rates, inflation and other economic fundamentals. In addition, reduction of RBM's holding of GoM securities is one of the triggers for the IMF's ECF Programme.

9. It should also be noted that, during the period under review, the foreign sector's holding of GoM securities increased from around 5 percent recorded as at end June 2017 to 12.17 percent as at end June 2018. Likewise, commercial banks also increased their holdings from 19 percent to 24.04 percent over the same reporting period. This increase was on account of RBM offloading its holdings of Government debt to the market.

10. As can be seen in Figure 2 below, discount houses, the corporate sector, households, other financial institutions, and Government/parastatals hold less than 3 percent of Government domestic debt combined.

Figure 2: End June 2018 - Government Domestic Debt by Holder



Source: Ministry of Finance, Economic Planning & Development and Reserve Bank of Malawi

E. EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

11. In the medium to long term, Malawi's external debt is sustainable and is classified as a moderate risk of debt distress. According to Debt Sustainability Analysis (DSA) results presented in the Table

2 below, Malawi's debt indicators do not breach the international thresholds. However, Malawi's debt is vulnerable to shocks related to exports emanating from weather shocks and changes in commodity prices on the international market.

12. For 2018, the external debt indicators in Present Value (PV) terms are as follows: Debt to GDP is 20.4 percent against an indicative threshold of 30 percent, Debt to Exports is 74.2 percent against an indicative threshold of 100 percent and Debt to Revenues is 102.7 percent against an indicative threshold of 200 percent, Debt Service to Exports 7.50 percent compared to 15 percent and Debt Service to Revenue is at 10 percent as compared to 18 percent threshold.

Table 2: Debt Sustainability Results

External Debt Indicators						
	Threshold	**2018**	**2019**	**2020**	**2021**	**2022**
	Percent					
PV of Debt to GDP	**30**	20.4	20.3	20.1	19.8	19.5
PV of Debt to Exports	**100**	74.2	72.2	71.3	70.0	69.0
PV of Debt to Revenue	**200**	102.7	104.5	103.7	101.6	99.4
Debt Service to Exports	**15**	7.5	5.4	5.3	5.2	4.0
Debt Service to Revenue	**18**	10.4	7.8	7.6	7.5	6.6
Public Debt Indicator						
PV of Debt to GDP	**38**	42.7	42.5	40.5	38.3	36.1

Source: Ministry of Finance, Economic Planning & Development

13. For public debt sustainability which assesses both external and domestic debt, Malawi's public debt to GDP was at 42.7 percent compared to the recommended benchmark of 38 percent. This means that by adding domestic debt to external debt, Malawi's risk of debt distress is heightened.

14. Unlike in the external DSA, only the ratio of the present value of public debt to GDP has a benchmark. Previously there was no internationally agreed threshold for this indicator, however, the World Bank and the IMF introduced benchmarks for present value of public debt to GDP based on a country's capacity to carry debt as guided by the World Bank's Country Policy and Institutional Assessment (CPIA) rating.

15. As shown in Table 4, weak performers (that is, those countries with a CPIA score of equal to or less than 3.25) may not be able to sustain public debt if the present value is more than 38 percent of GDP while medium and strong performers can sustain higher levels of PV of public debt of up to 56 and 74 percent, respectively, beyond which public debt becomes unsustainable.

Table 4: Indicative Benchmarks for Public Debt

Policy Performance category (CPIA)	PV of total public debt in percent of GDP
Weak Performers (CPIA < = 3.25)	38
Medium Performers (3.25 > CPIA < 3.75)	56
Strong Performers (CPIA = > 3.75)	74

Source: International Monetary Fund

16. Given that Malawi is classified as a weak performer in terms of policies and institutions, the applicable benchmark is 38 percent. However, debt sustainability is gauged by looking at the trend depicted by present value of public debt to GDP. When the projected debt burden indicators depict an increasing trend, it signals fiscal unsustainability, but Malawi's debt sustainability results show declining trend over the projection period. Specifically, PV of public debt to GDP is projected to go down in the medium term and expected to reach 38.3 percent in 2021 and remain below the benchmark over the long term.

F. RISK AND COST ANALYSIS

17. Malawi's public debt is exposed to re-financing[1], interest and exchange rate risks. The refinancing (and/or roll-over) risk and interest rate risk are on account of the short-term debt instruments, in particular treasury bills.

As of end-June 2018, refinancing risk measured by the Average Time to Maturity (ATM) indicates that domestic and external debt had an ATM of 2.7 years and15.3 years, respectively and for total public debt, the ATM stood at 8.7 years. The longer the ATM the lower the refinancing risk.

[1]Re-financing risk is the risk that debt may be rolled-over at high interest rates or may not be rolled-over at all.

For debt maturing within one year, analysis shows that 43.8 percent of the domestic debt will mature in 2018/19 Financial Year (FY) implying high exposure to refinancing risk. In terms of foreign exchange risk, 50.1 percent of Malawi's debt stock was denominated in foreign currency, meaning that half of Malawi debt is susceptible to fluctuations in the exchange rate.

Table 5: Risk and Cost indicators

Risk Indicators		External debt	Domestic debt	Total debt
Amount (in Billions of MWK)		1,502	1,497	2,999
Amount (in millions of USD)		2,070	2,063.0	4,132.5
Nominal debt as % GDP		28.4	28.3	56.8
Cost of debt	Interest payment as % GD	0.3	2.0	2.3
	Weighted Av. IR (%)	1.1	6.9	4.1
Refinancing risk	ATM (years)	15.3	2.7	8.7
	Debt maturing in 1yr (% of	3.1	43.8	24.3
	Debt maturing in 1yr (% of	0.8	12.8	13.6
Interest rate risk	ATR (years)	15.3	2.7	8.7
	Debt refixing in 1yr (% of t	3.1	43.8	24.3
	Fixed rate debt (% of total	100.0	100.0	100.0
FX risk	FX debt (% of total debt)			50.1
	ST FX debt (% of reserves)			7.3

Source: Ministry of Finance, Economic Planning & Development

G. PLANS TO REDUCE DEBT LEVELS

18. Government is committed to exercise prudent debt management by executing debt management strategies that will ensure that the required amount of funding is raised at a minimum risk and costs. Government seeks to ensure that both the level and rate of

growth in the public debt is fundamentally sustainable and can be serviced while meeting cost and risk objectives.

19. Going forward, Government realises that the current structure of domestic debt in terms of maturity is fuelling the growth of domestic debt. In recognition of this, Government is restructuring its domestic debt so that maturity is lengthened. Government through RBM has so far issued Two and Three Year-Notes in 2018/19 FY with the objective of lengthening the maturities. As noted before, the ATM of the domestic debt stands at less than three years. Almost 13 percent of domestic debt is expected to mature in a year. It is envisaged that debt restructuring will assist in reducing the cost of debt and lengthen the maturity profile.

20. Another prominent contributor to the rising domestic debt was Promissory Notes which were issued to settle suppliers' arrears. Thus, accumulation of arrears massively contributed to the skyrocketing of domestic debt level as such Government has put in place mechanisms to strengthen contracts management. Ministries Departments and Agencies (MDAs) are implored to commit Government only when cash flows permit them to spend thereby averting accumulation of arrears.

21. In addition, Government recognises fiscal risks associated with guaranteed debt. To that end, Government is putting in place sound policies for managing contingent liabilities. One of the policy proposals is that all State Owned Enterprises (SOEs) with guaranteed debt will be required to open an account with the RBM where funds will be deposited on regular basis for debt servicing. Currently, Government is closely monitoring guaranteed debt so as to minimize the likelihood of call outs/ materialisation.

22. Government is aware that to effectively reduce its debt, efficiency in revenue mobilisation as well as in its expenditures is of paramount importance. This can potentially create fiscal space or surpluses that can be directed to retiring the existing debt. It is therefore, Government's intention to enhance its revenue mobilisation efforts, especially under the broader category of non-tax revenue. This will include close monitoring and accountability by revenue generating MDAs to make sure that all that is collected is accounted for. It is only a sustained registering of a positive fiscal balance that can enable Government to retire its debt sustainably.

H. CONCLUSION

23. Malawi's external debt is sustainable. However, total public debt exhibits rising vulnerability emanating from the structure of the

domestic debt portfolio. Specifically, Malawi's public debt portfolio is exposed to a number of refinancing, interest rate and exchange rate risks.

24. As of end-June 2018, the country's debt was at MK2.9 trillion representing 56.7 percent of GDP in nominal terms. This is within the recommended level of 60 percent as per the Southern African Development Community (SADC) Macroeconomic Convergence Criteria.

25. However, in terms of Present Value of debt to GDP, Malawi's debt was at 41 percent which is slightly above Malawi's threshold of 38 percent as guided by the internationally recommended benchmark.

26. In light of this, Government, among other things, is committed to: (i) reduce the debt levels in particular domestic debt through strengthening of public financial management; (ii) lengthening the maturity profile of domestic debt portfolio in order to reduce refinancing and interest rate risks; (iii) improving contracts management; (iv) monitoring contingent liabilities; and (v) enhancing revenue collections.